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Supreme Court of the United States

OCTOBER TERM, 1940

No. 465

IN THE MATTER

of

DEEP ROCK OIL CORPORATION, a corporation,
Debtor,

STANDARD GAS AND ELECTRIC COMPANY,
Petitioner,

against

JOHN M. TAYLOR, *et al.*, as the Preferred Stockholders Independent Committee, JOHN J. SHINNERS, *et al.*, as a Reorganization Committee of Deep Rock Oil Corporation, H. N. GREIS, Trustee of Deep Rock Oil Corporation, THE SECURITIES AND EXCHANGE COMMISSION, Intervenor, and DEEP ROCK OIL CORPORATION.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

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a corporation,
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JOHN M. TAYLOR, *et al.*, as the Preferred Stockholders Independent Committee, JOHN J. SHINNERS, *et al.*, as a Reorganization Committee of Deep Rock Oil Corporation, H. N. GREIS, Trustee of Deep Rock Oil Corporation, THE SECURITIES AND EXCHANGE COMMISSION, Intervenor, and DEEP ROCK OIL CORPORATION.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

To the Honorable, The Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, STANDARD GAS AND ELECTRIC COMPANY, by its counsel, A. Louis Flynn, Jacob K. Javits and Wilbur J. Holleman, alleges:

A. STATEMENT OF THE MATTER INVOLVED*

Order appealed from.

The instant petition seeks to review an order in the reorganization proceedings of Deep Rock Oil Corporation, a Delaware corporation (hereinafter referred to as "Deep Rock" or "Debtor"). By this order (R. 159, f. 219), the District Court for the Northern District of Oklahoma (1) denied to Standard Gas and Electric Company (hereinafter referred to as "Standard") any participation in the reorganization of Deep Rock or against the estate of Deep Rock, "although", the District Judge decreed, "from the evidence it might be found that Standard has a valid claim" (R. 160); (2) adjudicated that the Debtor is the owner of all the issued capital stock of Deep Rock Oil and Refining Company (hereinafter referred to as the Refining Company), and of the Bradstreet Properties and of the Cracking Plant; (3) directed Standard to deliver to the Trustee of the Debtor a note of the Refining Company for the principal sum of $1,894,592.11, "marked paid", a deed to the Cracking Plant and certificates for the issued and outstanding stock of the Refining Company; and (4) adjudicated as invalid the claim of Standard against the Refining Company upon the note of $1,894,592.11 and for $8,227.94 in cash loaned by Standard to the Refining Company since the inception of the receivership proceedings and

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*This case is the result of further proceedings which followed the decision of this Court in *Taylor* v. *Standard Gas and Electric Company*, 306 U. S. 307, 59 S. Ct. 543, 83 L. Ed. 669 (1939). Subsequent to that decision, Standard filed an amended proof of debt. This petition relates to proceedings affecting the amended proof of debt (R. 91).

for $41,706.25 loaned by Standard to the Refining Company prior to the inception of the receivership proceedings.

From this order, Standard appealed to the United States Circuit Court of Appeals for the Tenth Circuit. Motions were made to dismiss the appeal and, in one case, to either dismiss the appeal or affirm the order below (R. 1362, *seq.*). The Circuit Court of Appeals denied the motions to dismiss the appeal (113 F. (2d) 266, 267; R. 1378, 2078) and without receiving briefs or hearing arguments on the merits, affirmed on the merits the order of the District Court. Circuit Judge Huxman wrote an opinion of affirmance in which Circuit Judges Phillips and Bratton concurred (113 F. (2d) 266, R. 1372, f. 2071).

Proceedings subsequent to the decision by this Court of *Taylor* v. *Standard*, 306 U. S. 307.

This appeal results from further proceedings had in the reorganization proceedings of Deep Rock consequent upon the decision of this Court in *Taylor* v. *Standard Gas and Electric Company, et al.*, 306 U. S. 307 (hereinafter referred to as the *Taylor* case). After the decision of the *Taylor* case by this Court on February 27, 1939, the parties to the cause sought to agree upon a new plan of reorganization susceptible of confirmation by the District Court pursuant to the mandate of this Court in the *Taylor* case (R. 44). These negotiations culminated in an agreement upon principles of a plan of reorganization on May 5, 1939 (R. 45, 1327, *seq.*), which the District Court directed be submitted to counsel for the Trustee for a report. The report of counsel for the Trustee suggested certain minor modifi-

cations in the agreed upon principles and advised the Court that:

> "We know of no other way by which effect can be given to the opinion of the Supreme Court, which recognizes Standard Gas and Electric Company as being entitled to a common stock interest in the reorganized company, despite the fact that the claims of creditors and rights of preferred stockholders, to which Standard is subordinated, exceed the appraised value of the debtor's assets as approved by the Supreme Court. Except through this stock there is no way for Standard to participate in ownership of the new company and at the same time be in the subordinate position required by the Supreme Court"* (R. 1325).

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*The plan agreed upon provided for $11,000,000 of Fifteen Year Debentures (to go to note holders), and 250,000 shares of Class A common stock of the par value of $10 each, having cumulative preferred dividends at the rate of $1.50 a share per annum and in liquidation a preferential right to $25 per share plus accumulated dividends. All the shares of Class A stock were to have voting rights. 200,000 shares of Class A stock were to go to the present preferred stockholders, the remaining 50,000 shares to be available for payment in kind of such compensation as the District Judge might allow to counsel for the Independent Preferred Stockholders Committee. In addition, there were to be issued 400,000 shares of Class B common stock, each share of which was to be entitled to one vote; the Class B common stock was to be junior in right to dividends and in liquidation to the Class A stock, and was to be subject to the further restriction that no dividends be paid on the Class B common stock unless an amount equal to such dividends be paid into a sinking fund for retirement of Class A stock until one-half of the Class A stock had been retired. Of the Class B common stock, 25% (100,000 shares) was to go to the note holders; 12½% (50,000 shares) was to go to the holders of the preferred stock; and the remaining 67½% (250,000 shares) was to go to Standard. Until the new debentures

On June 14, 1939, an appearance in the proceeding was entered in the District Court on behalf of the Securities and Exchange Commission (hereinafter referred to as the S. E. C.). The S. E. C. immediately indicated to the representatives of security holders that it considered that Standard was entitled to no participation in the reorganization (R. 45, 46). Thereupon the Reorganization Committee declined to file a plan based on the principles which had been agreed upon in writing by its representatives and those of the various parties; further efforts of the parties to agree upon a plan of reorganization conforming to the mandate and opinion of the Supreme Court granting participation to Standard were fruitless. It is obvious, therefore, that the parties recognized a right in Standard to participate in the reorganization based on the Supreme Court's decision but that it was the position of the S. E. C. in endeavoring to promote in this case a general policy not designed for or applicable to this case which made it impossible for the parties to consummate their agreement and close the case (R. 46, 47).

"Speculators'" Purchases of Deep Rock Securities

On December 15, 1939, the District Court, on its own motion, entered an order directing that the holders of notes

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had been paid in full, the voting rights of all the stock were to be exercised by five voting trustees, one of whom was to be designated by the Reorganization Committee, one by the Independent Preferred Stockholders Committee, one by Standard and two by the District Court. It will be observed that the voting shares allocated to Standard (250,000 shares) did not exceed the voting rights allocated to the preferred stockholders and were substantially less than the aggregate voting rights of the note holders and preferred stockholders (R. 1327, *seq.*).

and preferred stock of the Debtor file statements with the Trustee stating the date of purchase or acquisition of their securities and the prices paid therefor (R. 72, f. 93). On January 29, 1940, the Trustee filed a report under said order (R. 123, ff. 174 *seq.*) to which report was attached a summary of the statements received from the holders of notes and preferred stock in response to such order of the District Court (R. 133). Of the holders of 70.13% of notes who responded to the order of the District Judge, approximately two-thirds had purchased their securities subsequent to March 1, 1933 (the date of the beginning of the proceedings), some at prices as low as 20% of the principal amount of such notes (R. 133). The precise prices paid by note holders were not disclosed, but attached to the report of the Trustee are statements of the market prices at which notes and preferred stock of the Debtor were traded in since March 1933 (R. 134-137). It will be observed that since March 1933, such notes have been traded in "flat" *i.e.,* the prices have been without regard to accrued interest. It will also be observed that out of the $4,114,500 principal amount of notes reported to have been acquired after the inception of the proceedings, $3,000,000 principal amount were acquired at less than 75% of face value, "flat" (*i.e.,* without regard to accrued interest) (R. 133). Accrued interest during the receivership—not paid for by those who purchased their securities "flat"—amounts to $4,200,000 or 42% of principal, according to the order of which petitioner complains.

The report shows with respect to the preferred stock that reports were received from the holders of 62.75% of the outstanding stock; that approximately 25% of the reporting stock was purchased or acquired subsequent to

March 1, 1933, some at prices less than $5 per share and all but 512 of such reporting shares at less than $25 a share (R. 134). Accrued dividends on the preferred stock since March 1933—not earned—amounts to $3,150,000!

It is a fair and reasonable inference that the greater number, if not all, of the holders of the 29.87% of outstanding notes and of the holders of the 37.25% of outstanding preferred stock who failed to report their transactions since March 1, 1933 purchased at or near the bottom of the prices reported during such period, *i.e.*, notes at 20% to 25% of the principal amount thereof "flat", and preferred stock at about $5 a share. (Compare Trustee's statement of the market prices for Deep Rock's notes and preferred stock during the receivership period, beginning March 1, 1933 (R. 134-137).) The District Judge, in his findings of fact, found that "since the inception of the receivership proceedings and the reorganization proceedings of the Debtor", large percentages of notes and preferred stock of the Debtor have been acquired by the present holders "at prices substantially below the principal amount thereof in the case of notes, or the preferential rights in liquidation in the case of the preferred stock" (R. 150).

Standard's Amended Proof of Debt, Filed December 28, 1939

On December 26, 1939, the District Court, by an order duly entered (R. 88), as amended by order of December 28, 1939 (R. 90), authorized the filing by Standard of an amended proof of debt. On December 28, 1939, Standard filed its amended proof of debt (R. 91, *seq.*).

The petition for leave to file the amended proof of debt (R. 74, *seq.*, f. 97, *seq.*) asserted that no disposition on the merits had ever been made of the original claim filed by Standard, that Standard is a publicly owned corporation with 37,068 stockholders representing a capital and surplus of $110,000,000 subject to indebtedness of $71,209,500 to 21,467 debenture holders and noteholders, that Standard (which was itself reorganized under Section 77B of the Bankruptcy Act in 1935-1938) is managed by a Board of Directors of whom a majority are elected by the public security holders of Standard, for whose benefit and on whose behalf Standard's claim is asserted, that in the absence of an agreement on a plan of reorganization it was necessary for the court to determine the amount of the claim of Standard, that the District Court on its own motion had directed the holders of notes and preferred stock to file with the Trustee a subscribed statement in writing showing, among other things, the date of purchase of notes and preferred stock of the Debtor and the prices paid therefor, that since the inception of the receivership proceedings notes of the Debtor had been purchased at prices as low as 20% of the principal amount thereof and preferred stock of the Debtor had been purchased at prices as low as $1 a share (inclusive of any dividend accumulations), that the holders of notes and preferred stock of the Debtor who acquired such interests during the pendency of the reorganization proceedings sought to be unjustly enriched in the proceedings at the cost and expense of the innocent security holders of Standard, that the court should take into consideration the prices paid by the present holders of notes and preferred stock of the Debtor in determining the propriety and extent of any subordination of any part

of the claim of Standard, that the proposed amended proof of debt would simplify the issues and eliminate from the claim all matters not relevant to a final determination of the claim on its merits. The petition requested the court to take testimony on the amended proof of debt with respect to the merits thereof and with respect to any equities pertaining thereto. The order granting leave to file the amended proof of debt was not appealed from.

The amended proof of debt (R. 91 *seq.*, f. 121 *seq.*) is for a claim in the amount of $6,129,248.36, and, unlike the original proof of debt (which is based on a running open account from 1919 to 1933), is based exclusively on specific transactions between Standard and Deep Rock occurring between February 24, 1928 and February 28, 1933. Briefly, the amended proof of debt includes only items (accruing within the period specified) of cash advanced by Standard to or for the benefit of Deep Rock (primarily to or for payment to strangers), less cash repaid by Deep Rock to Standard, interest, dividends declared but not paid on preferred and common stock of the Debtor owned by Standard, interest on Deep Rock securities owned by Standard, and charges assigned to Standard by the Management Corporation for engineering and management services.

A summary of the items included in the amended proof of debt is printed at page 100 of the Record. It is followed by detailed schedules supporting every item of claim (R. 101-108).

Proof Offered in Support of Standard's Claim

On January 29 and January 30, 1940, the District Court for the first time in this case heard testimony with respect to the merits of the amended claim of Standard Gas and

Electric Company* (R. 1185-1313). At the same hearing, and, therefore, mingled in the record of such hearing, the District Court also considered a proposed amended plan of reorganization filed by the Reorganization Committee (after intervention by the S. E. C. and following its views), and heard evidence with reference to the value of the assets of the Debtor, submitted in connection with such plan.

At the hearing on its claim, Standard introduced evidence, substantially uncontroverted, fully supporting every item in its amended claim (R. 1264, *seq.*). Vouchers and checks were produced in proof of every cash disbursement comprehended in Standard's claim (R. 1266). Standard also introduced uncontroverted evidence, in the form of the report of the Trustee (R. 123, *seq.*; 1239), with respect to the prices at which notes and preferred stock of Deep Rock have been acquired by their holders during the receivership period; the fact that Standard is in effect a corporate description for 37,068 holders of the stock and 21,467 holders of the notes and debentures of Standard (R. 1268); the fact that the cost to Standard of money during the period covered by the amended proof of debt exceeded the rate of 7% per annum as charged in the amended claim upon loans from Standard to Deep Rock (R. 1268); the fact that during the period referred to, of the amount comprehended in the proof of debt, $1,000,000 in cash was paid directly by Standard to the note holders of the Debtor

*Previously, the District Court had heard argument only on the question of compromise. Testimony offered before the Special Master with respect to Standard's original claim was introduced in evidence and constitutes a portion of the proof (to the extent relevant) on the amended proof of debt (R. 1262, 1263).

(R. 1269) as interest on their notes and $597,129.75 in cash was paid directly to the public preferred stockholders of the Debtor as dividends on their stock (R. 1269) and $1,300,428.98 in cash was used for operating purposes of the Debtor (R. 1269, 1270).

Mr. Lynch, President of Standard, and personally familiar with the relationships and dealings between it and the Debtor, testified (R. 1296-1307) that in no instance was any loan made by Standard to Deep Rock for the direct or indirect benefit of Standard (R. 1296) nor to obtain "a stranglehold" upon Deep Rock; that Standard had never used its power to compel Deep Rock to borrow money from it (R. 1296); that Deep Rock could not have borrowed money from any source other than Standard except through giving security, something which Standard did not exact (R. 1297); that Standard never interfered in Deep Rock's relationships with its preferred stockholders, creditors or strangers (R. 1297); that Deep Rock's initial capitalization was adequate and that the need for additional capital developed, after Deep Rock started in business, as a result of radical changes in the oil business, a condition not chargeable in any way, directly or indirectly, to factors within Standard's control (R. 1298); that after the refunding operation in 1928, Deep Rock's financial condition was such that it had adequate working capital for all its requirements, and that the need for money, which resulted in the creation of the indebtedness which is the subject of the amended proof of debt, did not arise until 1929, when it came as a result of a decision by the operating officers of Deep Rock to extend its properties (R. 1299); that the dividends paid to preferred stockholders of Deep Rock were paid only because it was in Deep Rock's interest that they should be paid (in order to maintain a satisfactory credit reputa-

tion) (R. 1299, 1300) and not to influence voting rights or for Standard's benefit (R. 1300, 1301); and that Standard was not in the business of selling securities nor interested in maintaining market prices for the preferred stock of Deep Rock (R. 1307).

For the first time since the inception of the proceedings was a record made before the District Judge on the merits of the claim of Standard, and the District Judge asked by Standard to allow its claim on the merits.

Petition of Standard for Equitable Compensation for Its Interests in the Refining Company

On January 29, 1940, Standard had also filed with the District Court a petition relating to the stock of the Refining Company (R. 117, *seq.*). The petition stated in substance that Standard has advanced all the moneys ($2,544,592.11) used in the acquisition of the Bradstreet Properties and Cracking Plant now owned by the Refining Company, all the capital stock of which is owned by Standard; that in 1922 it became necessary for the Debtor to acquire additional oil acreage and a cracking plant, the need for acreage being due to depletion of oil reserves then owned by the Debtor and the need for the cracking plant being due to rapid technological advances in the oil production industry; that the financial condition of the Debtor was such that it lacked the money necessary for the acquisition of such leases and for the erection of a cracking plant; that the Debtor also lacked the credit necessary to enable it to obtain a license for the use of patented processes in the operation of the cracking plant; that the operating officers of the Debtor requested Standard to lend sufficient funds; that between 1922 and October 1, 1925, Standard provided $2,544,592.11, and between October 1, 1925 and

February 28, 1933, $41,706.25 additional, and during the entire period pledged its credit in order to obtain the necessary licenses for the use of patents; that the purpose of the acquisitions was to afford to Deep Rock, the Debtor, the use of the Bradstreet Properties and the Cracking Plant and at the same time to preserve to the fifty-eight thousand security holders of Standard, whose money was being used for the purpose, security for the realization of their investment acquired through the use of their moneys; that legal and/or equitable title to the property so acquired and to the cracking plant has therefore been in Deep Rock Oil and Refining Company since October 1, 1925; that the Debtor has enjoyed all the use, income, issues and profits of such leases of the cracking plant and has paid to the Refining Company for such use in the aggregate only $500,000; that the leases between the Refining Company and the Debtor (described in the opinion of this court in the *Taylor* case) have been objected to on the ground that such leases were not the result of arm's-length bargaining by parties of equal contracting capacity and are and were onerous, inequitable, and an unfair burden on the Debtor; that a great benefit was conferred by petitioner on the Debtor in providing the oil producing premises and cracking plant and making available the licenses for use of patents; that it was essential for Standard to protect its investment disbursed for the acquisition of such oil producing properties and cracking plant from the possible claims of the then bondholders of the Debtor (which bonds have since been satisfied by due payment thereof in cash in full) or otherwise to subject the property so acquired through the disbursements of Standard's funds and the pledge of its credit to the claims of other creditors and stockholders of the

Debtor; that the procedure followed in the acquisition by the Refining Company (the stock of which is owned by Standard) of the Bradstreet Properties and Cracking Plant was undertaken in good faith for the benefit of the Debtor accompanied by an effort made in good faith to protect the advance of new money derived from the fifty-eight thousand public securityholders of Standard; that the receiver and trustee of Deep Rock have successively operated the properties of the Refining Company and during the course of such operation such properties have depreciated in value partly through obsolescence, partly through the removal and extraction of oil, and partly through wear and tear; that the net balance of the moneys paid by Standard for the acquisition of the Bradstreet Properties and the erection of the Cracking Plant and for improvements and additions is $2,073,798.36; that reasonable compensation in the form of interest at 5% per annum, compounded semi-annually on the unpaid balance of these amounts between February 24, 1928 and February 28, 1933 would amount to $649,582.97, and from February 28, 1933 to December 1, 1939 simple interest at the rate of 5% per annum would amount to $919,408.56; that in addition, since the inception of the receivership and reorganization proceedings, petitioner has expended $8,227.94 for corporate purposes of the Refining Company even though control of all the property has been in the trustee of the Debtor; that interest at 5% per annum on Standard's cost is less than the amount of rental reserved in the leases.

Standard requested the court to determine the fair amount of compensation to be paid by the receiver and trustee for their use and occupancy of the premises during the period of administration by the court, and that the

trustee be directed to either pay such amount as determined by the court and surrender possession and control of the Refining Company properties or in the alternative pay to Standard for its interests therein the amount of its investment therein with 5% interest (R. 117-123).

Answers to the petition were interposed by various parties. The answer of the Securities and Exchange Commission (R. 144) contends that the Supreme Court has already considered Standard's interest in the Refining Company property and decided exactly what the District Court decided in the order which petitioner seeks to have reviewed. The Reorganization Committee in its answer takes the same position that the Supreme Court had already adjudicated title to the property, and in addition states that Standard expended only $650,000 for the acquisition of the property; it also states that Standard in 1928 received common stock of the Debtor in cancellation of the open account indebtedness of Deep Rock to Standard, which included rentals of $1,475,000 accrued prior to 1928 (R. 137). The record shows that this stock when received did not materially alter Standard's interest in the Debtor as a common stockholder and was of doubtful value (R. 357, 358). The answer of the trustee (R. 142) says that Standard has spent not more than $500,000 for the acquisition of the properties in question. The answer of the Preferred Stockholders Committee (R. 147) alleges that the Supreme Court had already adjudicated all the issues involved in the proceeding.

The discrepancies between the admission of the trustee that Standard paid $500,000 for the acquisition of the Refining Company properties, and of the Reorganization Committee that Standard paid $650,000 and Standard's assertion that it spent $2,544,592.11 arise in this way:

Standard paid $500,000 in cash initially to the vendor of the Bradstreet Properties (R. 294); an additional $150,000 was paid to the vendor in the form of three notes of the Debtor, which Standard paid at maturity (R. 295); the remaining $1,894,592.11 represents construction costs of the Cracking Plant, the moneys for which were advanced by Standard to Deep Rock for disbursement as construction proceeded (R. 303, 311, 540, 698). These advances were advanced for a special purpose and were made through Deep Rock for convenience during the period of construction; Deep Rock acted as a conduit for these advances (R. 351, f. 535).

The record contains an itemization of every disbursement made by Standard in connection with the acquisition of the Refining Company properties (R. 1332, ff. 1846-1849). The record also shows that Deep Rock profited from the use of the Refining Company's assets to the extent of more than $4,500,000 up to the beginning of the receivership proceedings (R. 312, 467, 891, 892).

At the hearings on January 28 and January 29, 1940, Standard introduced additional evidence in support of its petition (R. 1274, 1275).

No argument was ever had or permitted to Standard on this petition. In the findings of fact and conclusions of law the District Judge nevertheless found that the properties of the Refining Company "were acquired by and for Deep Rock and belonged to Deep Rock" and that "whatever claim, if any, Standard may have arising out of transactions concerning" the Refining Company properties is "that of a creditor having a claim for money against Deep Rock, and said claim is of the identical character of all other claims, if any, of Standard against said Debtor" (R. 150). The order which petitioner seeks to have reviewed

directs Standard to surrender to the Trustee its interest in the Refining Company, including the capital stock and note of that company, and excludes Standard from any compensatory participation in the reorganization of the Debtor.

District Judge Holds Exclusion of Standard from Participation is Inequitable, as Standard Has a Legitimate Claim

At the conclusion of the testimony, the District Court read a memorandum which he had prepared in which he urged a plan of reorganization making provision for Standard's participation (R. 1307 *seq.*) (which plan the District Judge must have considered to be in conformity with the opinion of the Supreme Court). The parties failed to agree upon this plan.

The hearing adjourned and re-convened on February 27, 1940, at which time the District Judge stated at the opening of the proceedings that he had already made up his mind as to the disposition of all matters pending before him, stating (R. 1314, *seq.*):

> "I will tell you what I am going to do about it. I have already made up my mind, and nobody can change it now. *I agree with you it is inequitable to subordinate your claim to the full amount of these note holders, taking into consideration the actual consideration paid by speculators for their notes pending this bankruptcy proceeding,* but the Supreme Court of the United States in this case, without going into details, said your claim must be subordinated to the note holders and to the preferred stockholders.
>
> "Now I will have to get Mr. Martin to get the figures, and I am going to make a finding as to what the record shows as to how much is due on these

notes, that is principal and interest, and how much preferred stock is outstanding, and how much in dividends is due on the preferred stock, and that under the opinion of the Supreme Court of the United States, and I am bound by it, you are subordinated to those claims, and therefore your claim is valueless, and has no value, and that you cannot have any part or participation in the reorganization of this company. Now that is the order I enter in the case.

"Mr. Levitan: I respectfully except to that, Your Honor, because I don't think the Supreme Court requires that subordination.

"The Court: You can take it back up there. * * *

"The Court: No. I will say this. I will say, yes, if there was any value above the note issue and the preferred stock, whatever this amended claim shows, *they would have a legitimate claim*" (R. 1316).

The district court refused to hear any argument with respect to the Refining Company petition, stating:

> "The Court: You understand what I want. I am trying to fix it so you will get your appeal" (R. 1317).

The Extent of the Subordination Decreed by the District Court.

On February 29, 1940, the District Court entered the order (R. 159, f. 219), which results in this petition, decreeing that the claims of creditors and note holders must be satisfied in full before Standard is entitled to participate in the assets of the Debtor, in liquidation, reorganization, or in any other manner whatsoever, the words "in full"

being defined for the notes as $10,000,000 principal amount plus interest at 6% per annum from March 1, 1933, amounting to $4,200,000, and for the no par value preferred stock as $5,000,000 plus dividends at the rate of $7 per share per annum on 50,000 shares, since January 1, 1931, amounting to $3,150,000 (thus disregarding completely the facts about the acquisition of notes and preferred stock by "speculators" during the pendency of the proceedings), and decreeing that the claim of Standard as a creditor and its interest as a common stockholder of the Debtor "are without value, since the claims of the creditors and note holders and the interests of the preferred stockholders substantially exceed the value of the assets of the Debtor", that Standard is not entitled to participate in the reorganization of the Debtor, that the amount for which the claims of Standard should be allowed is unimportant and immaterial and it is unnecessary for the court to pass upon the amount or validity of the claim of Standard although, the District Judge found, "from the evidence it might be found that Standard has a valid claim" (R. 160), that the Debtor owns all the stock of the Refining Company and is the owner of the Bradstreet Properties and of the Cracking Plant and that Standard should transfer to the Trustee the note of the Refining Company held by it, in the amount of $1,894,592.11, "marked paid", and deeds of conveyance of the Cracking Plant and certificates covering all the issued stock of the Refining Company, that Standard has no valid claim on account of the $1,894,592.11 note of the Refining Company held by it, or for $8,227.94 (being the amount of cash expended by Standard for the corporate purposes of the Refining Company since the beginning of the receivership, March 1, 1933) or for the amount of $41,706.25

loaned by Standard to the Refining Company for the maintenance and operation of the Bradstreet Properties and Cracking Plant.

Findings of Fact by the District Court

The findings of fact by the District Court (R. 148) substantially parallel the order appealed from. No findings were made as to the amount of Standard's claim—although Standard requested such findings (R. 153, *seq.*)—and although the District Judge stated in the order that "from the evidence it might be found that Standard has a valid claim" (R. 160). No controversy has ever existed about the fact that Standard has a valid legal claim for most of the items comprehended in its amended proof of debt.

The Opinion of the Circuit Court of Appeals

The opinion of Judge Huxman (R. 1372) recites briefly the history of the cause, the order appealed from, the contentions of Standard that this court had not decided in the *Taylor* case that Standard must be excluded if the assets of the Debtor were less than the sum of (1) principal and interest accrued on the notes during the receivership, and (2) liquidation priorities of preferred stock over the common stock, including dividends accrued during the receivership proceeding.

Standard's additional contentions before the Circuit Court were that in the *Taylor* case, this court, in the exercise of powers conferred by subsection (b) (2) of Section 77B of the Bankruptcy Act (which relates to what a plan of reorganization may include), had ruled that the plan of reorganization and concomitant order of compromise must be reversed since "equity requires the award to preferred

stockholders of a superior position in the reorganized company," 306 U. S. 307, 323; that in the *Taylor* case, this Court had disapproved the offer of compromise because the plan of reorganization "subordinated preferred stockholders to Standard"; that this Court had held in the *Taylor* case that if a reorganization is effected control should be divided so that preferred stockholders have at least equal voting rights with Standard and a right of participation in the equity prior to that of Standard, 306 U. S. 307, 324; that this Court had not adjudicated the merits of Standard's claim and had not decided that Standard must or may be excluded; that in its opinion in the *Taylor* case where it stated "In the present case there remains an equity after satisfaction of the creditors in which only the preferred stockholders and Standard can have an interest," (306 U. S. 307, 322) this Court had left open the precise formula for a division of the equity remaining after satisfaction of the debt (notes), and indicated that such division should be according to equitable principles; and that this Court had not sanctioned expressly or inferentially the palpable inequity of the decision of the District Court.

In answer to these contentions, which the opinion does not consider, Judge Huxman merely held that this Court had decided that Standard's claim had been subordinated to the position of the preferred stockholders of Deep Rock for all purposes. The Circuit Court made no attempt to consider the equities of Standard's position *vis-a-vis* the equities of the positions of preferred stockholders and note holders of Deep Rock. The Circuit Court assumed that Standard has a valid claim and then erroneously assumed, without analysis or discussion, that the mandate of this Court in the *Taylor* case required "that the claim of note

holders be first satisfied; that the claim of the preferred stockholders be next satisfied; and that any balance remaining belonged to Standard" (113 F. (2d) 266, 269; R. 1377). The only explanation which the Circuit Court had for those paragraphs of the opinion of this Court in the *Taylor* case, which give a right of participation to Standard, was that if before the final consummation of any plan of reorganization the assets of Deep Rock should so increase in value that there would be a substantial equity over the notes plus all accrued interest and the preferred stock plus all accrued dividends, whether earned or not, to be applied to the satisfaction of Standard's claim, the court could make this equity available to Standard! (113 F. (2d) 266, 269; R. 1376, 1377)

The Circuit Court made no mention at all in its opinion of Standard's contentions with respect to the Refining Company, as set forth in the petition of January 29, 1940 (R. 117; see pp. 12-16, *supra*).

The decree of the Circuit Court of Appeals was entered on June 29, 1940. From the decision of the Circuit Court of Appeals, this petition for certiorari is taken.

B. THE QUESTIONS PRESENTED

1. Did the Supreme Court in *Taylor* v. *Standard Gas and Electric Co.*, 306 U. S. 307, decide (as assumed by the District Court and by the Circuit Court of Appeals) that the note holders of Deep Rock must first be satisfied to the extent of the full principal amount of their notes ($10,000,000) plus interest throughout the receivership and reorganization proceedings ($4,200,000, *i.e.*, at the rate of 6% per annum), and that the holders of the no par value

preferred stock must be next satisfied to the extent of the preference in liquidation of the preferred stock over common stock, including accrued dividends throughout the receivership and reorganization proceedings (even though unearned) (a total of $8,150,000 of which $3,150,000 represents accrual of dividends at the rate of $7 per share per annum), before any provision may be made for Standard as a creditor, regardless of the fact that since the beginning of the receivership and reorganization proceedings, "speculators" have acquired notes at prices as low as 20% of the principal amount thereof "flat" (*i.e.* inclusive of interest) and preferred stock at prices as low as—and, indeed, less than—$5 per share?

2. Does equity permit the preclusion of Standard from participation in the reorganization of Deep Rock, solely for the benefit of holders of notes and preferred stock of Deep Rock, a substantial part of which securities were acquired at small fractions of face amount during the receivership and reorganization proceedings of Deep Rock, in view of the uncontroverted fact that cash advanced by Standard to Deep Rock within the period covered by the amended proof of debt, in excess of repayments, amounted to $3,082,689.91 (R. 1267), of which $1,000,000 was paid directly to the holders of notes on account of interest on their notes, and $597,129.75 to the holders of preferred stock on account of dividends, and $1,300,428.98 was provided for the Debtor for the purpose of enabling it to pay essential operating and corporate expenses?

3. Whether the principles of a court of equity do not require that Standard as a creditor for $6,129,248.36 (or such lesser amount as the court might determine in an adjudication on its own equities of each item of claim) be

accorded fair participation in the reorganization of the Debtor?

4. Did the Supreme Court decide in the *Taylor* case that Standard must be deprived of its stock in the Refining Company and of the note of the Refining Company, representing a net cash investment therein of $2,082,026.30, without receiving compensation therefor notwithstanding the fact that the Debtor enjoyed vast financial benefits through the use of the properties of the Refining Company?

5. Were the standards of due process of law and the standards of equity, as established by this court, violated by the District Court in directing Standard to transfer to the Trustee without compensation the stock and note of the Refining Company and the Bradstreet Properties and Cracking Plant?

6. Did the District Court have jurisdiction to adjudicate the validity of the claim of Standard against Deep Rock Oil and Refining Company and to order cancellation of that claim?

C. REASONS FOR GRANTING CERTIORARI

The reasons for granting certiorari in this case are:

1. Correction of grave injustice.

A grave injustice and inequity has been done to fifty-eight thousand public security holders of Standard (R. 1268) whose interests have been entirely excluded from participating in the reorganization of Deep Rock by a decision which the District Judge who rendered it considered inequitable (R. 1314). The District Judge acted in

the belief that he was under compulsion of the decision of this Court in the *Taylor* case to render such decision (R. 152); as a matter of fact no such compulsion existed, since the *Taylor* case did not decide the issues involved in the order complained of; the *Taylor* case dealt with a voluntary, agreed-upon reorganization, whereas the order now appealed from is one of complete bar and foreclosure against Standard.

Standard has a net cash investment in Deep Rock of $20,567,763.74 (R. 1270). The claim of Standard includes $3,000,000 of net cash advanced by Standard since 1928 (*i. e.,* in excess of cash repayments); of these net cash advances, the sum of $1,000,000 was paid directly to the note holders of the Debtor, the sum of $597,129.75 was paid directly to the public preferred stockholders of the Debtor, and the sum of $1,300,428.98 was provided to the Debtor for operating purposes (R. 1269, 1270). In addition, the Debtor, and through it the holders of notes and preferred stock, have enjoyed vast financial benefits from the exploitation of the Refining Company properties, paid for by Standard (R. 307, 313, 891, 892, 1333-1335). The order below gives this property to the holders of notes and preferred stock outright, without providing any compensation to Standard. Note holders have enjoyed the direct benefit of the payment to them of $1,000,000 of Standard's money, and preferred stockholders have enjoyed the direct benefit of receiving $600,000 of Standard's money. Having received these sums from Standard, should Standard be prevented from recovering them from the Debtor? As to these items there cannot be the remotest suggestion that equity requires a disallowance or subordination. At the least, Standard should stand in no worse position than would have

stood those who received its money, and should not be foreclosed from any recovery. The moneys were advanced solely for Deep Rock's benefit, and not for Standard's benefit (R. 1296, *seq.*).

The palapable inequity of the result of which petitioner complains is the more shocking because of the fact that the note holders and preferred stockholders of Deep Rock now claim a right of priority not only for the principal but also for interest at 6% per annum, and unearned dividends of $7 per share per annum accrued during the entire receivership period while the property was in the custody of and being administered by the court! The unconscionable position of the note holders and preferred stockholders is emphasized by the fact that (as the District Judge found) many of them are "speculators" who acquired their securities during the reorganization proceedings, with full knowledge and notice of the existence of Standard's claim, and seek to make vast profits and be unjustly enriched (R. 150) at the expense of and misfortune to the fifty-eight thousand public security holders of Standard having almost $185,000,000 invested in it (R. 78) and through Standard having over $20,000,000 of cash invested in the Debtor (R. 1270).

Stated pointedly: will this court permit the unjust enrichment of and windfall to "speculators" who purchased their securities at tremendous discounts from face amount on the assumption that Standard had a valid claim, at the expense of Standard's fifty-eight thousand public security holders? What rule of equity or justice could require the shifting of so vast a windfall to one group of persons and the imposition of so grave a misfortune upon another innocent group of security holders?

2. Conflict with applicable decisions of this Court.

This unjust result the courts below have sought to explain on the ground that they were bound by a decision of this Court *requiring* such result. Petitioner submits that such explanation and the decisions based thereon are in conflict with the decision of this Court in the *Taylor* case. The lower courts reached their judgment only through the misreading of this Court's opinion and through the unwarranted extension of this Court's decision.

What this Court decided in the *Taylor* case had to do with the securities which Standard was to receive under a new plan of reorganization—those securities were to be subordinated in character to the securities to be awarded to the preferred stockholders and were to represent voting rights not greater than those allotted to the preferred stockholders. At no place in its opinion in the *Taylor* case did this Court talk of subordination of Standard or Standard's claim except in terms of an award to Standard of participation in a plan of reorganization, or decree that the measure of subordination of Standard's position was principal and interest to date in the case of the notes plus "par" and accrued (though unearned) dividends to date on the preferred stock, or decree that Standard must transfer its interests in the Refining Company to the Trustee without receiving compensation for its investment therein of upwards of $2,000,000 cash.

It is apparent from the opinion of this court in the *Taylor* case that this Court did not attempt to decide the issues which were subsequently drawn; it is clear too that this Court's opinion assumed that the parties would ultimately agree on a new plan of reorganization, consistent with the

opinion. This Court directed the lower Court to apply to any further proceedings the precepts of equity. Because of the opposition of the Securities and Exchange Commission to any participation by Standard, an agreed-upon plan was ultimately found to be impossible (R. 46). In excluding Standard as a creditor from participating in the reorganization, the District Court and the Circuit Court, apparently without realization that they were doing so, proceeded to extend the decision of this Court in the *Taylor* case to a holding that this Court's opinion *required* that Standard be denied participation, in effect expunging Standard's claim, and refused to consider the merits or the equities. The District Court indicated clearly that equity required a different result (R. 1239, 1314).

Petitioner does not believe that in the *Taylor* case this Court intended to deny Standard participation or that it could have reached such a decision on the basis of the incomplete record then before it, or that this Court would reach so harsh and unjust a result.

To reach the decision below, the District Court and the Circuit Court must have questioned both the arithmetic and the comprehensibility of this Court; for after confirming the $17,000,000 appraisal of the Debtor's assets and deducting the provision made for the note holders, this Court had stated:

> "If a reorganization is effected the amount at which Standard's claim is allowed is not important if it is to be represented by stock in the new company, provided the stock to be awarded it is subordinated to that awarded preferred stockholders. No plan ought to be approved which does not accord the preferred stockholders a right of participation in the equity in the Company's assets prior to that of Standard,

and at least equal voice with Standard in the management" (306 U. S. 307, 324).

Petitioner considers that the quoted portion of this Court's opinion contains a suggestion as to how the standards of fairness might be applied in a subsequent plan of reorganization in this case. These standards were clearly indicated: the securities to be awarded Standard must be subordinate in character to those awarded preferred stockholders, and must enjoy no greater voting right. The District Court and Circuit Court both misunderstood the mandate of this Court. The Circuit Court, seeking to explain away the quoted part of this Court's opinion, offered the strange explanation that what this Court "*could* have contemplated" was that there would be "an enhanced value of these assets" because Deep Rock's property fluctuates greatly and increases rapidly in value! (113 F. (2d) 266, 269; R. 1377).

3. Departure from usual course of judicial proceedings and other conflicts with applicable decisions of this Court.

The District Court so far departed from the accepted and usual course of judicial proceeding (and the Circuit Court of Appeals impliedly sanctioned such a departure) as to call for an exercise of this Court's power of supervision. Petitioner has reference here to the refusal by the District Court to grant petitioner a hearing on its application relative to its interest in Deep Rock Oil and Refining Company. Without considering the issues involved in the petition filed by Standard and without providing for any compensation whatsoever to Standard for its $2,082,026.30 of cash investment, for which it retained a security interest

in the Cracking Plant and Bradstreet Properties,—indeed without a notice that affirmative relief against Standard was being sought or contemplated—the District Court ordered Standard to transfer to the Trustee its interests in the Refining Company. The District Court declined to consider the matter, perhaps with the intention of helping Standard reach this court and a just result, for the District Court stated in this connection "I am trying to fix it so you will get your appeal" (R. 1317). The proceeding of the District Court with respect to the Refining Company denied Standard due process of the law, and the order complained of in its entirety denied Standard the application of the fundamental principle of equity jurisdiction: "he who seeks equity must do equity", *Southern Pacific Company* v. *Bogert,* 250 U. S. 483, 39 S. Ct. 533, 63 L. Ed. 1099 (1919). The Circuit Court of Appeals passed over this situation entirely without comment.

In no pleading before the Court was an issue raised with respect to whether the note of the Refining Company held by Standard was valid or whether Standard should be directed to mark such note "paid", or whether Standard had received payment of such note; in no pleading before the Court was an issue raised as to whether Standard should be affirmatively ordered to transfer the stock of the Refining Company to the Debtor without receiving compensation. Standard was therefore denied notice and hearing, essential prerequisites of due process.

4. An important public issue is involved in this case.

Standard, a publicly owned company with fifty-eight thousand security holders, made very large cash advances

to a subsidiary. In the *Taylor* case, this Court determined that Standard's position as a creditor could not be enforced according to its strict legal priority but only according to the standard of a "court of equity." This standard required that each case be approached on its own facts. The decision which petitioner seeks to have reviewed, however, goes so far as to create grave doubts as to whether any corporation making advances to a subsidiary will not be denied recovery, except in subordination to the claims and interests of all other persons. Thus, a vital question of public law in the administration of publicly owned corporations is involved in the question: Shall the innocent security holders of Standard be deprived of all participation in the Deep Rock reorganization, regardless of the merits of each item of claim (a result which the District Judge considers inequitable), because Standard's relationship to Deep Rock was that of parent-subsidiary and because of acts antedating the reorganization of Standard itself? That is the effect of the decision below, and that decision casts doubt on innumerable corporate balance sheets in this country.

It is submitted that in the interests of justice this court should exercise its power of supervision to correct the grave error which has occurred.

D. RELIEF

Wherefore, petitioner respectfully prays that a Writ of Certiorari be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Tenth Circuit, commanding that Court to certify and send to this Court, on a day certain to be therein designated, a full and complete transcript of the

record and of all proceedings in this cause, to the end that this cause may be reviewed and determined by this Court; and that the said decree of the said Circuit Court of Appeals in the said case, and every part thereof, may be reversed by this Court; and that petitioner be granted such other and further relief as may be just and proper.

Dated: New York, September 26, 1940.

A. Louis Flynn,
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Supreme Court of the United States

OCTOBER TERM, 1940

No.

IN THE MATTER
of
DEEP ROCK OIL CORPORATION,
a corporation,
Debtor,

STANDARD GAS AND ELECTRIC COMPANY,
Petitioner,
against

JOHN M. TAYLOR, *et al.*, as the Preferred Stockholders Independent Committee, JOHN J. SHINNERS, *et al.*, as a Reorganization Committee of Deep Rock Oil Corporation, H. N. GREIS, Trustee of Deep Rock Oil Corporation, THE SECURITIES AND EXCHANGE COMMISSION, Intervenor, and DEEP ROCK OIL CORPORATION.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I. Opinions of courts below.

The oral opinion of the District Court is printed at page 1314 of the record. The opinion of the Circuit Court of Appeals for the Tenth Circuit is officially reported in 113 F. (2d) 266, and is printed in the record at pages 1372-1378.

II. Jurisdiction.

The decree of the Circuit Court of Appeals was entered on June 29, 1940 (R. 1378). The statutory provision which is believed to sustain the jurisdiction of this Court is Section 240 (a) of the Judicial Code as amended (28 U. S. C. A. Section 347).

III. Statement of the case.

The essential facts of the instant case have been stated in the foregoing petition, to which reference is respectfully made.

IV. Specifications of Error.

The District Court erred in its order of February 29, 1940 and the Circuit Court of Appeals for the Tenth Circuit erred in affirming the order because:

1. Under the substantially undisputed facts of the instant case and as a matter of law and equity, Standard is entitled to the allowance of its claim as a creditor of Deep Rock, and is entitled to participate in the reorganization of the Debtor as a creditor.

2. The claim of the note holders for $10,000,000 principal, plus $4,200,000 of interest at 6% per annum accrued during the receivership and reorganization proceedings, and the claim of the preferred stockholders for $100 per share ($5,000,000 in the aggregate) plus $3,150,000 of dividends thereon at the rate of $7 per share per annum accrued during the receivership and reorganization proceedings are not entitled to satisfaction in full before making any provision for Standard as a creditor.

3. To satisfy the claim of the note holders and the interests of the preferred stockholders to the extent above mentioned, particularly taking into consideration the low prices at which such securities were purchased during the receivership and reorganization proceedings, would unjustly enrich holders of Deep Rock securities at the expense of the fifty-eight thousand public security holders of Standard.

4. On the basis of the record, equity requires that the claim of Standard be allowed on a parity with the claims of the note holders of the Debtor at least to the extent of cash advanced by Standard between February 24, 1928 and February 28, 1933 to and for the account of the Debtor (in excess of repayments), the net amount of such advances being $3,082,689.91, and interest thereon. (Of such amount the sum of $1,000,000 in cash was paid by Standard directly to the holders of the notes of the Debtor on account of interest between February 24, 1928 and February 28, 1933, the sum of $597,129.75 was paid by Standard during said period to the preferred stockholders of the Debtor in payment of dividends on their preferred stock duly declared by Deep Rock, and the sum of $1,300,428.98 was paid by Standard to Deep Rock between February 24, 1928 and February 28, 1933, for payment of operating and corporate expenses of the Debtor).

5. On the basis of the record, Standard is also entitled to a claim for interest on indebtedness due to it from the Debtor, the claim for such interest to rank on a parity with the claims for the particular items of indebtedness.

6. On the basis of the record, Standard is also entitled to a claim against the Debtor for the amount of $160,-

945.75, with interest, for dividends on the preferred stock of the Debtor owned by Standard, which dividends were duly and lawfully declared by the Debtor, but which dividends the Debtor failed to pay. Standard is entitled to such claim in seniority to the interests of the public preferred stockholders of the Debtor, who collected such dividends so declared in cash.

7. On the basis of the record, Standard is also entitled to a claim against the Debtor, on a parity with the claims of the holders of notes of the Debtor, for interest on $4,250,000 principal amount of notes of the Debtor, due December 31, 1931, for the period January 1, 1928 to April 12, 1928, with interest thereon to February 28, 1933, and to a claim against the Debtor for dividends of $840,672 duly declared by the Board of Directors of the Debtor, but not paid, with interest to February 28, 1933, and, on a parity with the claims of the holders of notes of the Debtor, for the fair value of the services rendered to the Debtor by Byllesby Engineering and Management Corporation (a wholly owned subsidiary of Standard) between February 24, 1928 and February 28, 1933, with interest to February 28, 1933.

8. Equity requires that Standard recover from the Trustee the possession and control of the Bradstreet Properties and Cracking Plant and fair compensation for the use and occupancy and operation of the Bradstreet Properties and Cracking Plant and by the receiver and by the trustee of the Debtor, and be allowed a claim against the Debtor for the fair value of its use and operation of such properties, unless there be paid to Standard the amount of its cash investment of $2,082,026.30 in Deep Rock Oil and

Refining Company (which owns the Bradstreet Properties and Cracking Plant), with fair compensation for the use of such monies. (Such sum includes the sum of $8,227.94 expended by Standard since February 28, 1933, the date of the beginning of the receivership of the Debtor, for the corporate purposes of Deep Rock Oil and Refining Company.)

9. So much of the order of February 29, 1940, appealed from, as requires Standard to transfer to the Trustee the capital stock of Deep Rock Oil and Refining Company, title to the Bradstreet Properties and Cracking Plant, and the note of the Refining Company held by Standard, is unlawful and is a deprivation of Standard of its property, without due process of law.

10. The District Court had no jurisdiction to adjudicate as invalid the claim of Standard against Deep Rock Oil and Refining Company and to order Standard to surrender, "marked paid", the note of Deep Rock Oil and Refining Company held by Standard.

V. Summary of argument.

For the sake of brevity, reference is respectfully made to the "Reasons for Granting Certiorari" contained in the foregoing petition for certiorari.

VI. Argument.

POINT I.

The decision which petitioner seeks to have reviewed relates to issues not decided by this Court in *Taylor* v. *Standard Gas and Electric Company*, 306 U. S. 307.

The accompanying petition does not represent an attempt to reargue any of the matters decided by this Court in the

Taylor case, nor does it seek an interpretation of the decision of this Court in that case, or to relitigate decided issues. The issues involved in the accompanying petition were not decided by this Court in the *Taylor* case, although both the District Court and the Circuit Court explained the result of which petitioner complains—a result which the District Judge considered inequitable (R. 1314)—as required by the decision of this Court in the *Taylor* case.

In the *Taylor* case, this Court did not adjudicate the merits of Standard's claim, nor subordinate Standard's claim to the amount of the claim of note holders for $10,000,000 principal, plus interest of $4,200,000, (being interest computed at the rate of 6% per annum during the entire period of receivership), and to the claim of the preferred stockholders for $5,000,000 ($100 per share), plus (unearned) dividends of $3,150,000 (at the rate of $7 per share per annum since 1931), before any provision may lawfully be made for Standard's participation as a creditor in the reorganization of the Debtor, nor adjudicate that Standard must transfer to the trustee of Deep Rock the stock and note of the Refining Company, representing a net cash investment by Standard of $2,082,026.30, without receiving compensation or reimbursement.

We do not presume to state to this Court what it decided in the *Taylor* case; we discuss that case only to the extent necessary for the presentation of our arguments. Our discussion comprises three points:

> (1) The scope of the issues decided in the *Taylor* case, for only as to matters within the issues is a judgment conclusive.
>
> *Norton* v. *Larney*, 266 U. S. 511, 517, 45 S. Ct. 145, 69 L. Ed. 413, 417 (1925);

North Carolina R. Co. v. *Story,* 268 U. S. 288, 295, 45 S. Ct. 531, 69 L. Ed. 959, 962 (1925);

Doe v. *Carpenter,* 18 How. 297, 302, 15 L. Ed. 389, 391 (1856);

Hill v. *U. S.,* 298 U. S. 460, 466, 56 S. Ct. 760, 80 L. Ed. 1283, 1288 (1936).

(2) Whether the decision in the *Taylor* case adjudicated Standard's interest in the Refining Company.

(3) Whether in the *Taylor* case this Court decided the exact extent of any priorities of note holders and preferred stockholders over the claim of Standard as a creditor.

1. This Court itself stated the question in the *Taylor* case to be "whether, within the bounds of reason and fairness", a division of the equity in the ratio of $4,234,000 to Standard and $1,020,000 to the preferred stockholders (the latter to be without representation on the Board of Directors) could be justified. 306 U. S. 307, 315.* The opinion must be read as an answer to that issue.

***The Circuit Court of Appeals in its first opinion in the *Taylor* case, (before that case reached this Court), also held that: "whether Standard was entitled to the allowance of its claim on the merits is not the issue here presented. That issue was never passed on by the Special Master or the Court. The real issue is whether the plan meets the requirements of Section 77B (b) (e) (f) of the Bankruptcy Act, as amended, 11 U. S. C. A. Section 207 (b) (e) (f), and is fair and equitable, and whether the court abused its discretion in approving the offer of compromise." 96 F. (2d) 693, 703.**

In response to the issue so posed by it, this Court held that the plan of reorganization and concomitant offer of compromise must be disapproved because, under the state of record then before the court, the plan of reorganization (based upon the offer of compromise) "subordinated preferred stockholders to Standard", and held that if a reorganization is effected, control should be divided so that preferred stockholders have at least equal voting right with Standard and a right of participation in the equity prior to that of Standard. This Court expressly did not consider or adjudicate the merits of Standard's claim, and restricted its decision to what "A plan of reorganization * * * (2) may include * * *" (306 U. S. 307, 322). This Court dealt only with the requirement that *the securities which Standard might receive in a plan of reorganization must be subordinate in character to the securities to be allotted to the preferred stockholders, and enjoy no greater voting rights.*

The record that was before this Court in the *Taylor* case had to do solely with the question of whether the plan of reorganization and concomitant compromise approved by the District Court should be reversed. Counsel in that case addressed themselves to the argument of the question of the circumstances under which an order approving a compromise should be reversed, and to the applicability of the so-called instrumentality rule to the claim of Standard, *i.e.*, whether the claim was non-existent because of the application of that rule. The merits of Standard's claim were referred to only incidentally for the purpose of showing sufficient probable validity to sustain a compromise, and not in an attempt to convince this Court that a decision on the merits would unquestionably have been in Standard's favor.

This Court in the *Taylor* case neither rejected Standard's claim on the merits nor denied its probable validity; the *Taylor* case merely held that the participation awarded Standard under the plan of reorganization was excessive and unfair *vis-a-vis* the preferred stockholders.

The opinion of this Court in the *Taylor* case referred to "abuses in management" (306 U. S. 307, 323). A Law Review writer has since commented, in 39 Columbia Law Review 907, 927 (1939)* that:

> "A culling of the record in the case yields no evidence that the management of Deep Rock was inefficient or wasteful. Furthermore, Brief of *Petitioners* states, in speaking of the supervision fees, '* * * Deep Rock's oil business was actually handled by its operating officers who were well experienced in the oil business * * *'."

2. In the *Taylor* case, this Court did not decide whether Standard must be required to transfer its interests in the Refining Company to the Trustee, without receiving compensation or reimbursement. This Court, in its decision in the *Taylor* case, did not decide or even discuss the issue of the ownership of the stock of the Refining Company and the title to and validity of the note of the Refining Company held by Standard.

The facts with respect to the Refining Company transaction, as they appear in the present record, which was

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***Claims Against Affiliated Companies in Reorganization, by Charles Rembar. Mr. Rembar is an attorney presently employed in the Reorganization Division of the Securities and Exchange Commission. We understand that his article was written before he associated himself with the Securities and Exchange Commission.**

not before this Court when the *Taylor* case was submitted, have been summarized at pages 12 to 16 of the accompanying petition. The full benefits of ownership of this property were enjoyed by Deep Rock and not by Standard (R. 313). We have not here a case where a parent seeks to profit at the expense of a subsidiary by taking to itself a corporate opportunity of the subsidiary; on the contrary, Standard paid for property but made it freely and unstintingly available for use by Deep Rock on terms more favorable than terms which Deep Rock could possibly have obtained from a stranger.

Seeking compensation for its investment, Standard entered into certain leases with Deep Rock. These leases are described in the opinion of this Court in the *Taylor* case (306 U. S. 307, 317-319). The relationship between Standard and Deep Rock was such as to permit Deep Rock, or its Trustee, to seek to disaffirm these leases; but such disaffirmance would not in equity deprive Standard of its right to retain its security interest in the property and of its right to receive compensation for the use of its property.

Southern Pacific Company v. *Bogert*, 250 U. S. 483, 39 S. Ct. 533, 63 L. Ed. 1099 (1919);
Thomas v. *Brownville, etc. R. Co.*, 109 U. S. 522, 3 S. Ct. 315, 27 L. Ed. 1018 (1883);
McCandless v. *Furlaud*, 296 U. S. 140, 167, 56 S. Ct. 41, 80 L. Ed. 121, 134 (1935).

In its amended proof of debt filed December 26, 1939 (R. 91) Standard abandoned any claim since 1928 based on the leases of the Refining Company. Even if there had been a disaffirmance and avoidance of the leases by court order, it would not follow that Standard could be

deprived of title to the Refining Company property without compensation. Yet that is what the courts below have attempted to effect. This Court did not so rule in the *Taylor* case.

3. In the *Taylor* case, this Court did not, and on the record before it could not, decide the exact extent of the priorities of note holders and preferred stockholders over the claim of Standard as a creditor.

Nowhere in the opinion of this Court in the *Taylor* case is there any statement with respect to the extent of priority of the claims or interests of note holders and preferred stockholders over the claim of Standard, except, perhaps, in these words: "In the present case there remains an equity after satisfaction of the creditors in which only the preferred stockholders and Standard can have an interest" (306 U. S. 307, 323).

Inferentially, if this sentence be removed from its context in the opinion, it may mean that the note holders are entitled to a priority over Standard. Actually, the plan of reorganization before this Court in the *Taylor* case was one in which Standard had agreed to the issuance of a senior security to the note holders; therefore, the issue before this Court, as stated by it, was "whether, within the bounds of reason and fairness", a division of the remaining equity of $5,800,000 in the ratio of $4,234,000 to Standard and $1,020,000 to the preferred stockholders (without representation of the preferred stockholders on the Board of Directors) could be justified (306 U. S. 307, 315). We believe that the opinion must be read as an answer to that question.

The record before this Court in the *Taylor* case precluded not only a decision by this Court of Standard's

claim on its merits, but also a consideration by this Court of all the equities which might determine the degree of subordination in the absence of a new plan of reorganization. Without seeking at this point to state the arguments in support of the proposition that equity requires that Standard as a creditor be awarded a participation in the reorganization of the Debtor (see Points II and III, *infra*), we point out that from the record in the *Taylor* case were absent the facts relative to the acquisition by large numbers of Deep Rock's security holders of their interests in the Debtor at prices representing fractions of the face amounts of their securities, a matter relating directly to the issue of whether equity will permit the unjust enrichment of such persons at the expense of Standard and its fifty-eight thousand security holders. This issue involves not the question of the enforceability of a contractual claim of a note holder or stockholder against the company with which he has made his contract; rather what is sought to be accomplished by the note holders and preferred stockholders here is, in effect, the enforcement of a claim against *Standard,* with whom they had no contractual relationships. Any such claim which may be enforced must be one subject to equitable considerations.

The failure of the courts below to give any effect at all to the pertinent equitable considerations, based on their erroneous assumptions that the decision in the *Taylor* case precluded them from so doing, will not bar this Court. This Court will not permit its opinion to be used as an "instrument of * * * injustice". *Thomas* v. *Brownville etc. R. Co.,* 109 U. S. 522, 526, 3 S. Ct. 315, 27 L. Ed. 1018, 1020 (1883).

POINT II.

The decision excluding Standard as a creditor from participating in the reorganization of Deep Rock is inequitable and violates the doctrine expressed in *Southern Pacific Company* v. *Bogert*, 250 U. S. 483.

Equitable considerations render impossible any justification of the decision of which petitioner complains. It is notable that the District Judge rendering the decision considered it inequitable (R. 1314) and made no effort to justify it. As we have pointed out above, neither the District Court nor the Circuit Court attached any weight to equitable considerations.

In its opinion in the *Taylor* case, this Court referred to the broad equitable principles expressed in *Southern Pacific Company* v. *Bogert*, 250 U. S. 483, 39 S. Ct. 533, 63 L. Ed. 1099 (1919). Petitioner believes that the principle expressed in that case governs and should determine this case. We quote from that opinion, 250 U. S. 483, 496, 497:

> "Some adjustment should obviously be made so as to compensate the Southern Pacific for any contribution made at its expense to the value of the stock in the new company of which the minority stockholders may get the benefit. *The purpose of this proceeding is not to punish the Southern Pacific, but to declare and enforce its obligation as trustee. The minority stockholders who seek equity should do equity; and a court of chancery has power in granting relief to prevent unjust enrichment of the minority stockholders at the expense of the Southern Pacific.*" (Italics ours.)

In *Thomas* v. *Brownville etc. R. Co.*, 109 U. S. 522, 526, 3 S. Ct. 315, 27 L. Ed. 1018 (1883), this Court required

those who sought equitable relief to do equity, compelling the applicants for relief "to pay fair prices for what they have received". This Court recognized in the *Thomas* case that *"any other terms would be unjust and would make the court the instrument of this injustice."* (Italics ours.)

We know of no doctrine or decision which detracts from the correctness or fundamental justice of the principle laid down by this Court in these cases. No attempt was made in either the District Court or in the Circuit Court to suggest that the decision of which petitioner complains meets the standards set forth in the *Bogert* case; on the contrary, the District Judge, as we have shown, considered that his decision was unjust (R. 1314). It was erroneously assumed by the District Court (R. 1317) and by the Circuit Court of Appeals that, by its opinion, this Court—the Supreme Court of the United States—prevented an equitable result and compelled a penal result!

A brief consideration of the equities in Standard's favor which would militate against any subordination of Standard's claim to the extent provided in the orders below, is in order:

1. Standard's cash investment in the Debtor, exceeding the sum of $20,000,000 (R. 1270), is more than the aggregate combined investment in the notes of the Debtor at the principal amount thereof ($10,000,000) and of the preferred stock of the Debtor at the "par" value thereof in liquidation ($5,000,000). The real parties in interest are Standard's fifty-eight thousand innocent security holders.

Duffy v. *Treide*, 75 F. (2d) 17, 19 (C. C. A. 4th, 1935);

In re Van Camp Products Co., 95 F. (2d) 206, 209, 210 (C. C. A. 7th, 1938) cert. den. 305 U. S. 605, 59 S. Ct. 65, 83 L. Ed. 384 (1938);

Cf. Jackson v. *M. H. Thomas Inv. Co.*, 46 F. (2d) 252, 254 (C. C. A. 5th, 1931);

Cf. also *Rapid Transit Subway Constr. Co.* v. *City of N. Y.*, 259 N. Y. 472, 491 (1932).

2. There is no evidence in the record that actual damage has been suffered or incurred by the note holders or preferred stockholders of the Debtor as a result of any act or omission on the part of Standard; or, conversely, that Standard has in fact enjoyed any profit from its relationships with the Debtor. The amended proof of debt excludes any claim for rentals of the Refining Company property, and submits to the court the question of the amount to be allowed for services rendered by the Management Corporation. Petitioner eliminated the rental items after consideration of the comments of this Court in the *Taylor* case. A law review writer has found that there was no evidence in the record of inefficient or wasteful management of Deep Rock or that the note holders or preferred stockholders were ever deprived of any money or of any property of value for the benefit of Standard. Rembar, "Claims Against Affiliated Companies in Reorganization", 39 Columbia Law Review 907 (1939).

3. Since the beginning of the receivership proceedings, the notes of the Debtor have been purchased in large amounts at great discounts from the face amount thereof (R. 133-137, R. 150); and although the holders of some

30% of notes and of 28% of the preferred stock of the Debtor failed to comply with the order of the District Court requiring them to file a statement of their cost (R. 133), it is only reasonable to assume that such holders have a cost substantially below the principal amount of such notes or the capital value of the preferred stock, and undoubtedly substantially below the average prices reported to the Court. The record shows the market prices at which these securities were traded in during the receivership period (R. 134-137). Those persons who acquired notes and preferred stock during the receivership and reorganization period (and certainly those who acquired them prior to the decision of this Court in the *Taylor* case) had full knowledge of the Debtor's financial difficulties, knew that they were buying securities which had not paid interest since the beginning of the receivership, and undoubtedly assumed that Standard's claim was valid and enforceable.* *Any* profit to such note holders and preferred stockholders resulting from a decision of this Court in the *Taylor* case would be in the nature of a windfall. Should this windfall go to the unconscionable extent of rewarding such purchasers of notes of the Debtor to the extent of paying them the principal amount of their notes plus interest during the entire receivership period at the rate of 6% per annum on the principal (not on cost or market values!) and subordinating Standard as a creditor to the full priorities in liquidation of the preferred stockholders including dividends accrued during the reorganization proceedings at the rate of $7 per share per annum?

***It must be remembered that the plan of reorganization which was reversed by this Court in the *Taylor* case in February 1939 had the affirmative approval of the holders of 82% of the notes and of 60% of the preferred stock.**

It cannot be argued in good faith that a doctrine which would avoid the harsh rule applied by the order complained of would impair the marketability of defaulted securities; for here, as we have pointed out, there is no question of the right of enforcement according to its tenor of defaulted securities against the issuer: *the question here simply is the extent of the windfall to accrue to the holders of such securities as a result of equitable considerations which require some debasement of the status of a creditor whom they presumed to be entitled to its full legal rights when they acquired their securities.*

4. A further consideration, which bears on the equity of excluding Standard from participation, is the speculative character of oil property, about which Judge Huxman, in the Circuit Court of Appeals, commented "It must also be borne in mind that the assets of Deep Rock consisted of oil property and leases, property that fluctuates greatly and increases rapidly in value," (R. 1377). A similar observation was expressed by the District Judge (R. 1312, f. 1815).

We mention the figures and testimony below for the purpose of emphasizing the inequitable result which would forever preclude Standard from sharing in the highly speculative earnings of Deep Rock, which has indicated a vast earning capacity.

The margin of error in evaluating oil properties is tremendous; one witness supporting the valuation (Mr. Francisco) testified that net earnings might be capitalized at eight to fifteen times their amount (R. 1205). Mr. Berend, another witness supporting the valuation, testified that the method of capitalizing net earnings, suggested by Mr. Francisco, was a method which he had not seen

applied in his thirty years in the oil business (R. 1226). Mr. Francisco testified that the appraisal relied on by the Court was based on a speculation as to the amount of oil to be recovered in the future and on the hypothetical price of $1 per barrel for oil in the future, the current price being $1.02 (R. 1210). The same witness testified that in his experience there is a large difference between actual recovery of oil reserves and estimates (R. 1210).

Mr. Berend testified that a new appraisal might show a difference of 10% to 15% one way or the other from the appraisal filed in Court (R. 1215).

It is important to note that the earnings of the Debtor during reorganization have been substantial; and that the properties of the Debtor have been improved substantially during the receivership period, according to the undisputed testimony of Mr. Greis, the Trustee (R. 1252). For the five years 1935-1939, total adjusted earnings from operations amounted to $10,064,292.20, making the average annual adjusted earnings from operations $2,013,858.44 (R. 1350 B). These earnings are subject to depletion and depreciation charges, estimated by the Trustee to average $1,230,136.13 annually, and to other charges, including interest on pre-receivership debt and income taxes. The net earnings before interest and federal income taxes, after all depletion and depreciation and all other charges, average $538,747.22 during each of the five years in question, reaching a high figure in 1936 of more than $1,000,000 (R. 1350 B). In view of the hypothetical assumption of a $1 price for oil in the future, and in view of present world conditions, the speculative possibilities of a great increase in Deep Rock's earnings bear directly on the equity of forever excluding Standard and unjustly enriching speculators in Deep Rock's securities.

As long as Deep Rock's vast speculative resources remain unexploited, Standard should have a right of participation; the cut-off date of Standard's interest as a creditor should not be the date of confirmation of a plan of reorganization under the circumstances of this case.

5. There are further equitable considerations, more amply considered in Point III below, such as the fact that among the items comprehended in Standard's amended proof of debt are the sum of $1,000,000, which Standard paid directly to the note holders of the Debtor, on account of note interest, and the sum of $597,129.75 which Standard paid to the public preferred stockholders of the Debtor on account of preferred dividends. There are the further facts (set forth more fully below) with respect to the Refining Company properties: that Standard has a net cash investment of more than $2,000,000 in such properties, for the use of which it has received no compensation and by the use of which the Debtor has been enriched to the extent of many millions of dollars (p. 64, *infra*).

We submit that the pertinent equitable considerations require that Standard be granted a participation in the reorganization of the Debtor, and that the courts below erred in deliberately refusing to do equity.

POINT III.

Standard has established a valid claim on the merits.

The existence of some valid claim in favor of Standard against Deep Rock is not challenged; indeed in the order signed by the District Judge, the fact is substantially admitted (R. 160). Petitioner asserts further that it has made out a prima facie case at the very least. *Cf. Whitney* v. *Dresser,* 200 U. S. 532, 26 S. Ct. 316, 50 L. Ed. 584

(1906). Such burden of proof as is imposed by the doctrine of *Geddes* v. *Anaconda Copper Mining Co.*, 254 U. S. 590, 41 S. Ct. 209, 65 L. Ed. 425 (1921), was fully met.

The constituent portions of the amended claim are set forth at page 100 of the Record. A brief description of the items of the amended proof of debt will show the reasons why Standard has been aggrieved by the decisions below. We also show, in the case of each item, the impact of the pertinent special equitable considerations.

1. Standard's right to a claim for net cash advances.

Petitioner asserts that it is entitled to a claim against the Debtor, on a parity with the notes of the Debtor, in the amount of $3,082,689.91 representing cash advanced by it to the Debtor and to others for the account and benefit of the Debtor between February 24, 1928 and February 28, 1933 (the date of the inception of the receivership proceedings), over and above all cash received by Standard from or for the account of the Debtor during said period, plus interest at the rate of 7% per annum, compounded monthly from the first day of the month following each charge or credit upon such cash items to February 28, 1933, amounting to the sum of $765,242.20.

As to such cash advances, no issue is raised by the record whether petitioner, in making cash loans to the Debtor or cash payments to strangers for the account of the Debtor, had any interests conflicting with those of the Debtor; nor is there the slightest doubt from the evidence that petitioner paid out the money, that of the money so paid out during the period included in the amended proof of debt, $1,000,000 was paid directly to the note holders of the Debtor, and $597,129.75 to the public preferred

stockholders of the Debtor (R. 1269). These are *net* cash advances, over and above repayments; it cannot be discerned from any evidence in the record that Standard received any reward or benefit as a result of such advances. To the extent of these sums, at least, *it would shock the conscience of a court of equity if the recipients were permitted to deny to Standard a claim at least on a parity with the claim they would have had against the Debtor had Standard failed to provide the necessary funds for payment to them.*

The record shows also that the sum of $1,300,428.98 of the total of $3,082,689.91 was used for operating purposes of the Debtor during the period in question, thus conferring a direct and immediate benefit on the note holders and preferred stockholders of the Debtor.

> *Cf. Virginia & Ala. Coal Co.* v. *Central R. & B. Co.,* 170 U. S. 355, 18 S. Ct. 657, 42 L. Ed. 1068 (1897).

There is no issue as to whether these advances were beneficial or detrimental to the Debtor—obviously they were of benefit to the Debtor, to its note holders and to its public preferred stockholders who received a large portion of the money. Standard received no moneys or property in return for its payments; the benefits enjoyed by it as a stockholder would have been the same whatever the source of the loans to Deep Rock. If avoiding receivership or liquidation that might have followed a default is a great benefit, how much greater was the benefit to the holders of notes and preferred stock who received cash and who were not demonstrably prejudiced in any way!

2. Standard's right to interest on its loans.

Standard claims to be entitled to interest on the above described advances at the rate of 7% per annum. The testimony now before the court shows conclusively and indisputably that Standard's actual cost of the use of money during the period in question exceeded the rate of 7% per annum compounded monthly (R. 1268). Conceding a power on the part of the Court as a court of equity to disallow any inequitable charges because of the relationship between Standard and the Debtor, it is submitted that the charge for interest made by Standard to the Debtor was not inequitable since Standard's own cost of the use of money for the period involved exceeded the amount charged, and since there is no proof whatever, and little probability, that the Debtor could have borrowed on more favorable terms from other sources. Further light on the equities is cast by the fact that the payments to note holders not only relieved the Debtor of the consequences of a default (which would have been detrimental to its preferred stockholders at least), but also of a charge of 6% per annum, compounded semi-annually. Payment of dividends to preferred stockholders avoided an accumulation of dividends at the rate of $7 per share per annum.

3. Standard's claim for debt due to dividend declarations (a) on preferred stock, and (b) on common stock.

a. The amount of Standard's claim based on dividends declared but not paid on preferred stock of the Debtor, owned by Standard, ought to stand either on a parity with the notes, or at the least, in a position superior to the claim of the preferred stockholders of the Debtor. We submit that, in the record now before the court, it is ade-

quately proven that the dividends were declared with the best interests of Debtor in mind and not with any intention of evading the minor and inconsequential voting rights of preferred stockholders (R. 1299-1301). The right to dividends is a full fledged debt of the Debtor entitled to full equality with any other claims.

All holders of preferred stock other than Standard have collected their dividends in cash. If the Court has the power to subordinate to some degree Standard's claim based on the declaration of such preferred stock dividends (amounting to $160,945.75, and interest thereon to the date of the inception of the receivership proceedings, amounting to $64,586.25), to the claims of creditors of the Debtor, in no event should such subordination have the effect of depriving Standard of a position enjoying priority over the preferred stock of the Debtor. If equity requires subordination of this amount to the claims of note holders, it would be manifestly inequitable for the preferred stockholders of the Debtor, who have collected their dividends in cash in full, to urge that Standard, which enjoyed a position precisely similar to theirs as a preferred stockholder, should not be entitled to a claim which they would have had had there been a failure to pay such dividends in cash following such declaration.

b. As to the item of claim based on dividends declared but not paid on the common stock of the Debtor owned by Standard, amounting to $840,672.00, with interest thereon of $277,224.93 to February 28, 1933: the record shows that these dividends were declared with Deep Rock's and only Deep Rock's interest in mind (R. 1300); that although payment of such dividends in cash would have involved recourse to further borrowing, it was to Deep Rock's interest,

from a credit point of view, to maintain a dividend paying record; and that dividends were declared out of earnings (R. 1299-1300). It is clear from the record that it was not because of Standard's paramount interest as a common stockholder that dividends on the common stock were declared; therefore the Court should not exercise its equitable power to subordinate this item of claim to the claims of creditors and interests of preferred stockholders.

The legal issues involved in the declaration of these dividends were submitted to this Court in the *Taylor* case and not decided. We do not here repeat the legal arguments except to note that the declaration of dividends in face of the need to borrow funds for payment is not necessarily born of improper motives.

Alabama Consolidated Coal & Iron Co. v. *Baltimore Trust Company,* 197 Fed. 347 (D. C. Md. 1912);

Cf. People of Colorado ex rel. Fraser v. *Great Western Sugar Company,* 29 F. (2d) 810 (C. C. A. 8th, 1928);

Splittgerber Bros. v. *Skinner Packing Co.,* 119 Neb. 259, 228 N. W. 531 (1930);

Wittenburg v. *Federal Mining & Smelting Co.,* 15 Del. Ch. Rep. 351, 138 Atl. 352, 55 A. L. R. 39 (1927).

4. Standard's claim to interest on securities of the Debtor.

As to the item of claim based on interest on $4,250,000 principal amount of Deep Rock 6% Gold Notes due December 31, 1931, amounting to $72,958.33 with interest of $29,799.93 to February 28, 1933: the record shows that the principal amount of the notes was contributed to Deep

Rock's capital in April 1928, accrued interest remaining unpaid (R. 353). Equity certainly does not require Standard to cancel or reduce interest which accrued prior to the date of cancellation of the principal of the debt. Standard asserts that as to this item and interest thereon, it is entitled also to a position of parity with the creditors of the Debtor.

5. Standard's claim based on services rendered by the Management Corporation.

As to the item of claim based on credits to Byllesby Engineering and Management Corporation, representing an assignment to Standard of amounts due and owing from Deep Rock to Byllesby Engineering and Management Corporation for services, to wit, $720,000 and interest thereon to February 28, 1933 in the amount of $166,462.98: the record shows that valuable technical, accounting, engineering, financial, purchasing, fiscal, etc. services were rendered by the Byllesby Engineering and Management Corporation to Deep Rock (R. 187, 188, 242, 243, 250-253, 310, 323, 342-347, 461) for which Deep Rock would have had to pay. Equity requires that there be assessed against Deep Rock the reasonable amount which Deep Rock would have had to pay to others for the services performed by Byllesby Engineering and Management Corporation. Equity may permit the court to deny or to subordinate so much of the charges of Byllesby Engineering and Management Corporation as represent any unfair profit which it is sought to enforce against Debtor.*

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*See *United Light & Power Company* v. *Grand Rapids Trust Co.*, 85 F. (2d) 331, 337 (C. C. A. 6th, 1936). In that case the Circuit Court held:

> "We think it is going too far to say that such contracts made by a corporation with its sole stockholder are void (citing cases) but, because they involve the

The amount of the charge which should be allowed to Standard was respectfully submitted to the District Court for decision. The Court refused to decide the question, although from the record it was clear that Byllesby Engineering and Management Corporation had maintained a large and expert organization available on call of the Debtor, and had rendered to the Debtor engineering, operating, financial, auditing, insurance, publicity and other services of value; all these services were needed by Deep Rock; one of the benefits enjoyed by Deep Rock was the benefit of discounts on purchases made by it through the facilities available to Byllesby Engineering and Management Corporation (R. 314, 315). Some allowance should in equity be made for this item.

We submit that the District Court should have considered each of the items in the amended proof of debt, the proof offered in support thereof, the absence of contradictory evidence, and should have tested the allowability of each item by the principles of equity; and upon such considerations, we submit Standard has proved a valid claim on the merits, and is entitled to participation as a creditor in the reorganization of the Debtor.

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relationship between the railway and its sole stockholder, they will be carefully scrutinized to see that they do not divert the assets of the railway to the stockholder without consideration. * * * Still, some services were rendered. * * * Intricate and extensive blueprints were prepared; savings were effected in insurance and in purchases of equipment and supplies. All this was worth something, and there is no substantial reason for disagreeing with the findings of the District Judge."

POINT IV.

Accrued interest of $4,200,000 on the notes of Deep Rock and accumulated dividends of $3,150,000 on its preferred stock (all of which accrued since the inception of the proceedings) may not properly be taken into consideration in determining the amount of the financial interests enjoying seniority over Standard.

The elimination of interest and dividends which have accrued since the inception of the proceedings leaves an equity of at least $2,449,000 for Standard, even assuming (without conceding) that the note holders and preferred stockholders are entitled to priority over Standard to the extent of $10,000,000 and $5,000,000 respectively, a total of $15,000,000. This computation is based on the valuation of $17,449,788.54 found by the District Court (R. 1311). Such a result would give to the *Taylor* case the effect of subrogating the preferred stockholders of the Debtor to the first $5,000,000 of Standard's interest as a creditor.

Petitioner submits that for the purpose of determining the amount of interest, if any, which should be computed on the claims of the note holders, the courts below should first have added the principal amount of the claim of the notes ($10,000,000) to the principal amount of Standard's claims, in order to determine whether the Debtor is solvent, allowing interest accruing after the inception of the proceedings only out of any excess over the sum of these debts. If the assets of the Debtor are insufficient to pay the principal amount of the claims against the estate as they existed on the date of the inception of the court proceedings, interest ought not to be calculated in favor of any creditors.

In this case, the sum of the claims at the beginning of the proceedings exceeds the value of the assets, taking into account the interest of Standard in the Refining Company.

The rule in bankruptcy proceedings is clear that interest will not accrue after the institution of proceedings for the purpose of determining the respective amounts of claims to free assets as between creditors.

Sexton v. *Dreyfus,* 219 U. S. 339, 31 S. Ct. 256, 55 L. Ed. 244 (1911);

Merrill v. *National Bank of Jacksonville,* 173 U. S. 131, 19 S. Ct. 360, 43 L. Ed. 640 (1899);

Thomas v. *Western Car Co.,* 149 U. S. 95, 13 S. Ct. 824, 37 L. Ed. 663 (1893);

Cf. American Iron & Steel Mfg. Co. v. *Seabord Air Line Ry.,* 233 U. S. 261, 34 S. Ct. 502, 58 L. Ed. 949 (1918).

This rule has been taken over in statutes, and is also part of the law of equity receivership.

Merrill v. *National Bank of Jacksonville, supra;*

Cf. Ticonic National Bank v. *Sprague,* 303 U. S. 406, 58 S. Ct. 612, 82 L. Ed. 926 (1938);

American Iron & Steel Mfg. Co. v. *Seabord Air Line Ry., supra;*

Thomas v. *Western Car Co., supra;*

Gamble v. *Wimberly,* 44 F. (2d) 329 (C. C. A. 4th, 1930).

While this rule has been described as a "rule of distribution", it has also been supported on the ground that no

person should gain an advantage resulting from the delay incidental to administration of assets by courts of law.

Attorney General v. *Supreme Council,* 206 Mass. 131, 92 N. E. 131 (1910);
People v. *American Loan & Trust Co.,* 172 N. Y. 371, 65 N. E. 200 (1902);
Tredegar v. *Seaboard Air Line Ry.,* 183 Fed. 289 (C. C. A. 4th, 1910).

This rule has been applied even though there were different rankings of priority among the unsecured creditors of the insolvent Debtor.

Solomon's v. *American B. & L. Association,* 116 Fed. 676, aff'd. 120 Fed. 1018 (C. C. A. 5th, 1903);
Atlantic National Bank v. *Four-States Grocery Co.,* 135 S. W. 1135 (Tex. Civ. App. 1911);
Hanson, Effect of Insolvency Proceedings on Creditors Right to Interest (1934), 42 Mich. L. Rev. 1069, 1071:

> "Where some of the claims are entitled to priority of payment, the general rule is that interest will not be computed and paid thereon unless the principal of all claims can be paid in full."

The reorganization statutes are bankruptcy laws and are founded upon the bankruptcy power of Congress.

Continental Ill. N. B. & T. Co. v. *C. R. I. & P. R. Co.,* 294 U. S. 648, 55 S. Ct. 595, 79 L. Ed. 1110 (1935).

In its opinion in this case, the Circuit Court stated that creditors holding prior liens are entitled to interest to the date of the payment out of the proceeds derived from property recovered from such lien (R. 1377). Neither the note holders nor preferred stockholders have a lien on any property in this proceeding; and the cases cited by the Circuit Court in support of its proposition are cases where prior lienors or tax claimants, enjoying a special status, were involved. They are not relevant here.

Preferred stock dividend accruals of $7 per share per annum should not be permitted during a period of administration of an estate by a court, particularly if not earned. We are not urging a repudiation of the Debtor's contract or of Standard's contract as a common stockholder; what we are talking about is the question of whether equity will permit subordination of Standard's position as a creditor to an accrual of $7 per share per annum of dividends on the preferred stock, even though not earned, while the estate is in process of administration by the court. We can see no equity in such a result.

Based on market prices of Deep Rock securities prevailing during the proceedings (R. 134-137), 6% per annum on the principal amount of notes and $7 per share per annum on the preferred stock result in fantastically high rates of interest.

It is respectfully submitted, therefore, that in any event, even assuming that the note holders and preferred stockholders must be accorded a prior position, an equity of about $2,500,000 remains in which Standard has an interest and of which Standard may not be lawfully deprived under the Bankruptcy Act.

If the actual prices at which note holders and preferred stockholders of the Debtor acquired their securities be

taken into account and if the sum of those prices be the amount to which Standard's claim should be subordinated, Standard's equity will necessarily exceed the sum of $2,500,000; the amount of the discounts from principal amount of notes and from $100 per share for the preferred stock, on the basis of the prices of these securities since March 1, 1933, as set forth in the Record at pages 134-137, aggregate many millions of dollars and would increase the amount of equity available to Standard. We submit that the amount to which Standard's claim may be subordinated in equity should never be greater than the actual consideration paid by the note holders and preferred stockholders for their claims and interests. While the record does not contain evidence to support a complete mathematical calculation of such aggregate cost (many security holders having failed to comply with the order of the District Court), on the basis of the reports submitted to the court as to securities acquired before and after the inception of the proceedings, it is a reasonable assumption that the equity remaining for Standard would be enough to satisfy most, if not all, of its claim.

POINT V.

So much of the order of February 29, 1940 as directs Standard to transfer to the Trustee of the Debtor the stock of the Refining Company and the note of the Refining Company "marked paid", without receiving any compensation for or reimbursement of its investment of $2,082,026.30, is an unlawful taking of Standard's property without due process of law.

The essential facts respecting the interest of Standard in the Refining Company are set forth in the accompanying petition for certiorari (*supra*, pp. 12-16).

From the record, it is clear that numerous and great financial benefits were enjoyed by the Debtor as a result of the Refining Company's properties (R. 313). Prior to 1925, the Debtor enjoyed from the operation of the Bradstreet Properties profits of $789,649.19 before retirements and $659,879.10 after retirements (R. 312, 467); in addition, during the same period, Deep Rock enjoyed profits from the operation of the Cracking Plant, the aggregate of such profits prior to October 1925 being $829,749.69 (R. 467). Thus, prior to the lease in 1925, Deep Rock enjoyed earnings from the Refining Company properties aggregating $1,619,398.88. Thereafter, Deep Rock has enjoyed further profits from the operation of the Refining Company (R. 891, 892), the amount of net earnings, disregarding rentals but after retirements of approximately $1,400,000, being the immense sum of $2,910,140.55, up to the beginning of the receivership (R. 891, 892). Deep Rock's earnings from the Refining Company's properties, prior to the beginning of these proceedings and before deduction of rentals, amounted to $4,529,539.43.

Since the beginning of the receivership, Deep Rock has continued to operate these properties and they have shown operating profits in operations (R. 1333). All these benefits have been enjoyed at Standard's cost. During the period ending December 31, 1932, depreciation and depletion accruals, "computed in accordance with provisions of the Federal income tax law and regulations," aggregated $3,208,349.81 (R. 821, 822). Further depletion and depreciation necessarily have been incurred during the reorganization proceedings (R. 1335).

Petitioner submits that the record justifies fully its contention that its property interests in the Refining Company cannot be destroyed without its being awarded fair com-

pensation. It is one thing to say that the leases described in the opinion of this Court in the *Taylor* case may be subject to disaffirmance at the instance of the Trustee of the Debtor; it is not the same thing to say that if the leases be disaffirmed, Standard, nevertheless, must surrender without compensation property representing a net cash investment on its part of $2,082,026.30. Deep Rock has enjoyed the benefits and has profited immensely from Standard's investment in the Refining Company. Standard is not seeking and never sought to avail itself of a corporate opportunity of Deep Rock nor to profit at Deep Rock's expense; it simply made a purchase, of which Deep Rock enjoyed all the benefits, Standard retaining title to the property to protect its own security holders. If Deep Rock needs this property it has a right to own it provided that it reimburse Standard on a fair basis.

The District Court failed to give any consideration to Standard's petition, saying "I am trying to fix it so you will get your appeal" (R. 1317). The Circuit Court did not mention this matter at all in its opinion. Opportunity to be heard on the petition was thus denied in the District Court, and even in the Circuit Court of Appeals, where the Court acted on a motion to dismiss the appeal and heard no argument on the merits. Due process requires an opportunity to be heard and to have judicial findings based on the hearing. These the District Court refused with relation to the Refining Company petition of January 29, 1940; and such refusal was a denial of due process.

Blackmer v. *United States,* 284 U. S. 421, 438, 52 S. Ct. 252, 76 L. Ed. 375, 383 (1932);

Baltimore & Ohio RR. Co. v. *United States,* 298 U. S. 349, 368, 369, 56 S. Ct. 797, 80 L. Ed. 1209, 1224 (1936)

American Surety Co. v. *Baldwin,* 287 U. S. 156, 168, 53 S. Ct. 98, 77 L. Ed. 231, 239 (1932);

Powell v. *Alabama,* 287 U. S. 45, 68, 69, 53 S. Ct. 55, 77 L. Ed. 158, 170 (1932).

Petitioner contends that the result of that part of the order which it is sought to have reviewed which relates to the Refining Company is a deprivation of petitioner's property without compensation. The bankruptcy power is subject to the Fifth Amendment.

Louisville Jt. Stock L. B. v. *Radford,* 295 U. S. 555, 55 S. Ct. 854, 79 L. Ed. 1593 (1935).

The result is obviously contrary to the principle of *Southern Pacific Company* v. *Bogert,* 250 U. S. 483, 39 S. Ct. 533, 63 L. Ed. 1099 (1919). It is contrary to the fundamental concepts of law and equity that any person's property may be arbitrarily taken for the use of another without compensation; if equity requires that Deep Rock have title to the Refining Company assets, it also requires that Standard receive just reimbursement and compensation; otherwise equity would be the unwitting means of effecting an unjust enrichment.

The arbitrary character of the decision below is evidenced by the order requiring Standard to mark "paid" the note of the Refining Company for $1,894,592.11 and to surrender such note to the trustee. Standard never received payment of such note; the direction to mark "paid" and transfer the note is not conditioned on payment: a fictional transaction has been ordered! Neither the note itself nor the Refining Company was before the Court, and no jurisdictional basis existed for either the direction to

mark "paid" or for the adjudication that the note was invalid. No pleading before the Court submitted the issue of validity of the note or the question of whether it should be marked paid. Jurisdiction is a prerequisite of due process.

CONCLUSION

We submit that the decisions of the Circuit Court of Appeals and of the District Court are erroneous as a matter of law. It is respectfully submitted that the grave injustice to fifty-eight thousand public security holders with an investment of upwards of $20,000,000, as well as the asserted reliance on an opinion of this Court to explain an injustice and inequity (which the District Judge admitted), and the departure by the courts below from the accepted standards of equity and justice should warrant this Court in granting certiorari in the instant case.

Dated: September 26, 1940.

Respectfully submitted,

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OCT 25 1940
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CLERK

Supreme Court of the United States

OCTOBER TERM, 1940

No. 465.

IN THE MATTER

of

DEEP ROCK OIL CORPORATION, a corporation,
Debtor,

STANDARD GAS AND ELECTRIC COMPANY,
Petitioner,

against

JOHN M. TAYLOR, *et al.*

PETITIONER'S REPLY TO RESPONDENTS' BRIEFS.

A. LOUIS FLYNN
JACOB K. JAVITS
WILBUR J. HOLLEMAN
SELIG J. LEVITAN
Counsel for Petitioner.

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Supreme Court of the United States

OCTOBER TERM, 1940

IN THE MATTER *of* DEEP ROCK OIL CORPORATION, a corporation *Debtor,* ——— STANDARD GAS AND ELECTRIC COMPANY, *Petitioner,* *against* JOHN M. TAYLOR, *et al.*	No. 465.

PETITIONER'S REPLY TO RESPONDENTS' BRIEFS.

POINT I.

RESPONDENTS' BRIEFS ERRONEOUSLY ASSERT THAT PETITIONER SEEKS TO RE-LITIGATE ISSUES ALREADY DECIDED BY THE *TAYLOR* CASE.

1. By loose reading of the reference of this Court to the *Taylor* case in *Pepper* v. *Litton*,[1] respondents find support for their assumption that this Court has already decided, adversely to Standard, the basic issue raised in the petition: whether this Court, in the *Taylor* case, subordi-

[1]308 U. S. 295, 60 S. Ct. 238 (1939).

nated Standard's claim as a creditor to the aggregate of the face amount of the notes, plus 6% interest to date, and to the preference on liquidation of the preferred stock plus accumulated dividends to date. We submit, however, that this Court did not use *Pepper* v. *Litton* as a vehicle for changing its mandate in the *Taylor* case. In the *Taylor* case, this Court spoke of subordination only in terms of the securities to be awarded to Standard as a creditor in the reorganization of the Debtor; the reference to the *Taylor* case in *Pepper* v. *Litton,* quoted in the briefs of respondents, also speaks of the claim of Standard being "allowed *to participate* in the reorganization of the subsidiary". This result could only receive practical expression by awarding to Standard in the reorganization of the Debtor securities junior in rank to those awarded to the preferred stockholders.

It is erroneously asserted in respondents' briefs that petitioner seeks to re-litigate issues determined in the *Taylor* case. This we flatly deny; we submit that this Court did not, in the *Taylor* case, decide the measure of subordination of Standard's claim as a creditor, but said that equitable considerations were to determine the treatment accorded Standard as a creditor in the reorganization. That is the only intimation which we can find in this Court's opinion as to what might or might not be done if the parties could not agree on a plan of reorganization.

2. Respondents argue that the contention of Standard that its claim in any event, ought not to be subordinated to the sum of the claims of note holders including interest[2]

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[2]**There is an apparent, but not a real, discrepancy between certain figures in the briefs of respondents and petitioner.**

during receivership and of preferred stockholders for the liquidating par value of the preferred stock and dividends accrued during receivership, (a) involves some repudiation of contractual liability and (b) is unsound, because to grant the contention might adversely affect the marketability of securities of corporations in reorganization. The facts do not support respondents' arguments. Petitioner does not urge any repudiation by the Debtor of its contractual liability, or the adoption of any principle (as argued by the S. E. C.) which would "destroy the marketability" of securities of corporations in reorganization. Standard has no contractual relationship with the note holders and preferred stockholders; therefore no question of repudiation of a contract is involved in the question of the measure of subordination of Standard's claim. No practical impediment exists to a reduction of the status of Standard as a creditor to a rank compatible with the equitable considerations, but the measure of this reduction is not by some law of nature or consideration of practical expediency required to be coextensive with the measure of the contractual rights against the Debtor of note holders

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At page 3 of the brief of the Reorganization Committee and at page 4 of that of the S. E. C., the value of the Debtor's assets is stated to be $16,500,000 and the debt to note holders as $13,000.000. Petitioner's brief states the corresponding figures to be $17,000,000 and $14,200,000. The apparent discrepancy is due to the fact that during the reorganization proceedings, $1,200,000 was distributed to the note holders. Restoration of this amount to both sides of the ledger does not alter the amount of the excess of assets over liabilities; however, it shows the value of assets of the Debtor to amount to $17,700,000 as against liabilities to the note holders of $14,200,000. The amount of $14,200,000 is the real measure of the priority asserted by the note holders.

and preferred stockholders upon liquidation.[3] Since subordination to any extent *must* result in an improvement in the status of the interests achieving seniority, marketability of the securities representing such interests would not be adversely affected. The question simply is the extent of the windfall to accrue in favor of such securities.

3. In neither brief of respondents is there a defense of the decision below as equitable or as consistent with the doctrine expressed in *Southern Pacific Company* v. *Bogert*.[4] The principal theme of respondents' arguments is that the decision of this Court in the *Taylor* case disposed of the issues involved in the petition, so that the harsh consequences of the order below "followed inevitably" this Court's decision in the *Taylor* case.

POINT II.

RESPONDENTS' ARGUMENT THAT SO MUCH OF THE ORDER OF FEBRUARY 29, 1940 AS DIRECTS STANDARD TO TRANSFER TO THE TRUSTEE OF THE DEBTOR THE STOCK OF THE REFINING COMPANY AND THE NOTE OF THE REFINING COMPANY "MARKED PAID", WITHOUT RECEIVING COMPENSATION, IS A RESTORATION OF THE STATUS QUO, IS CONTRARY TO THE FACTS IN THE RECORD.

1. In defense of the order of February 29, 1940, respondents contend that in effect there has been a restora-

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[3]Thus, for example, it could be provided that the holders of notes and preferred stock of the Debtor be subrogated to Standard's normal participation as a creditor to the extent of the actual cost of their securities, Standard retaining the amount of its normal participation in excess of the portion preëmpted by such subrogation.

[4]250 U. S. 483, 39 S. Ct. 533, 63 L. Ed. 1099 (1919).

tion of the parties to the positions which they occupied before the transaction of October 1, 1925 (in which Standard acquired the stock of the Refining Company, and the Refining Company issued to Standard its note of $1,894,592.11). (Reorganization Committee brief, p. 4; S. E. C. brief, p. 17.) It must, however, be obvious that the order fails to restore the status quo, and that it is impossible to restore Standard to the status quo. A rescission will not be ordered where it has become impossible to restore the status quo, and where one of the parties has enjoyed all the fruits.[5]

The record shows (and it is admitted in the answers) that Standard and not Deep Rock paid directly to the vendor (a stranger) $500,000 for the purchase of the Bradstreet properties (R. 294-295; R. 137). This amount was never charged by Standard to Deep Rock and was never a part of any open account indebtedness owed by Deep Rock to Standard (R. 294). The order of February 29th does not attempt to restore the status quo; indeed it alters the status quo in directing a conveyance to Deep Rock of property which it never owned. It contains no provision restoring or awarding to Standard any right in exchange for the transfer of this property.

There can be no "restoration" of any claim against the Debtor for the $500,000 paid by Standard directly to the vendor of the Bradstreet Properties, because for that amount there never was any claim against it. The only way to restore the status quo with respect to the Bradstreet Properties would be to pay to Standard the money it paid to buy that property. A restoration of the status quo in

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[5] *Stoffela* v. *Nugent*, 217 U. S. 499, 54 L. Ed. 856, 30 S. Ct. 600 (1910).

this case would in reality necessitate a refund to Standard of its net cash investment in the Refining Company of $2,082,026.30. Since 1925, the Debtor has enjoyed the fruits of the Refining Company properties, while conditions have so changed that the restoration of a claim against it would be a nebulous consideration.

The attempt to distinguish the *Bogert, Brownville* and *Furlaud* cases at pages 17-18 of the brief of the S. E. C., fails to give due regard to the facts. As we have stated, title to the Bradstreet Properties was never in the Debtor. Further, since October 1925, Standard has expended the sum of $41,706.25 (plus an additional $8,227.94 since the beginning of the receivership) to preserve the property and corporate status of the Refining Company (R. 1332 A, B). We submit that the most fundamental concepts of equity, often expressed by this Court, have been violated by the decisions below.

2. Standard did not receive a due hearing with respect to the matters encompassed in the Refining Company petition. On January 29 and 30, 1940, when hearings took place before the Court, issue had not been joined on Standard's petition, as admitted in the brief of the S. E. C. (p. 21). Indeed, one of the answers to the petition was not filed until April 23, 1940 (R. 147). Standard knew on January 30, 1940 that issue would be joined in the future, but that is obviously not the same as issue already being joined.

On pages 1316 to 1317 of the Record it appears that on February 27th, Standard's counsel requested of the District Court the privilege of addressing himself to the Refining Company petition, and that the Court declined to permit argument, stating "I am trying to fix it so you will

get your appeal." The Court had already stated "I have already made up my mind, and nobody can change it now" (R. 1314). From the juxtaposition of these events, from the refusal of the District Judge to make separate findings of fact and conclusions of law with respect to the Refining Company petition (R. 159), and from the finding of fact by the District Judge that the claims of Standard with respect to the Refining Company property are of "identical character of all other claims" of Standard against the Debtor (R. 150)—a finding which cannot be sustained from the record, as we have shown—it is apparent that the District Court rested his determination not on the evidence with respect to the Refining Company but rather on the assumption that this Court by its decision in the *Taylor* case had completely foreclosed Standard from participation in the reorganization and had required Standard to transfer to the Debtor, without compensation, its interests in the Refining Company.[6]

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[6]The petition of January 29, 1940 relating to the Refining Company property is not, as respondents state, a restoration of the items in the original claim amended in the proof of debt. By the petition of January 29, 1940, Standard offered two alternatives: (1) that it transfer to the Debtor the Refining Company properties and stock in the Refining Company, free and clear of the note, receiving in return the amount of its investment with fair compensation, or (2) that Standard be permitted to recover possession of the Refining Company property and be paid fair compensation for the use of such property by the Debtor, its receiver and trustee. Under the original claim, Standard retained the property and claimed a rental, the amount of which exceeded the amount claimed by Standard under either alternative offered in the petition of January 29, 1940.

CONCLUSION.

In denying to Standard any participation as a creditor in the reorganization of the Debtor, the District Court rendered a decision which he considered inequitable. The Circuit Court did not attempt to defend the justice of that decision. Neither have the respondents. All have apparently assumed that injustice will be tolerated as the necessary consequence of the opinion and mandate of this court in the *Taylor* case.

The brief of the Reorganization Committee urges this Court to promote an injustice in order to avoid further delay in consummation of the reorganization. Delay cannot be charged Standard; the same Reorganization Committee and the Trustee both supported the plan of reorganization which this Court disapproved in 1939. It is indeed a novel suggestion to this high Court that in the interests of expediency it sanction injustice.

We respectfully submit that the petition for certiorari should be granted in this case.

Dated: October 24, 1940.

Respectfully submitted,

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Supreme Court of the United States

OCTOBER TERM, 1940

No. 465

In the Matter of
DEEP ROCK OIL CORPORATION, a corporation,
Debtor,

STANDARD GAS AND ELECTRIC COMPANY,
Petitioner,

vs.

JOHN M. TAYLOR, et al., as the Independent Committee for the Protection of the Holders of Preferred Stock of Deep Rock Oil Corporation; JOHN J. SHINNERS, et al., as a Reorganization Committee; H. N. GREIS, Trustee of Deep Rock Oil Corporation; SECURITIES AND EXCHANGE COMMISSION; and DEEP ROCK OIL CORPORATION,
Respondents.

BRIEF ON BEHALF OF THE INDEPENDENT COMMITTEE FOR THE PROTECTION OF THE HOLDERS OF PREFERRED STOCK, THE REORGANIZATION COMMITTEE, AND H. N. GREIS, TRUSTEE, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

I.

INTRODUCTORY STATEMENT

Under date of February 27, 1939, this Court entered its opinion in this proceeding upon an extensive record and concluded that the District Court erred in approving a certain compromise of the claim of Standard Gas and Electric Company against its subsidiary Deep Rock Oil Corporation, the debtor herein, and the Plan of Reorganization based upon such compromise. In its opinion the Court discussed in detail the history of the relationship between Standard and Deep Rock and all of the items included in the Standard

claim and determined "the rights and the status of the preferred stockholders arising out of Standard's wrongful and injurious conduct in the mismanagement of Deep Rock's affairs." (306 U.S. 307, 322) The Court stated that an equity existed "after satisfaction of the creditors [Deep Rock noteholders] in which only the preferred stockholders and Standard can have an interest" and awarded to the preferred stockholders a "superior position" in that equity.

Later this Court in *Pepper* v. *Litton*, 60 S. Ct. 238, 246; 308 U.S. 295 (1939), characterized its holding in the instant case as follows:

> "In *Taylor* v. *Standard Gas and Electric Company*, 306 U.S. 307, this court held that the claim of Standard against its subsidiary (admittedly a claim due and owing) should be allowed to participate in the reorganization plan of the subsidiary only in subordination to the preferred stock of the subsidiary. This was based on the equities of the case—the history of spoliation, mismanagement and faithless stewardship of the affairs of the subsidiary by Standard to the detriment of the public investors."

The pending petition is an effort to relitigate in this Court the status and right of Standard to participate as a creditor in the reorganization of the debtor. Standard even asks that certain items in its claim be allowed on a parity with the notes. (Pet. pp. 34-37) The same supposed equities are urged which this Court has already repelled and the same claim is advanced which this Court has already subordinated.

As we shall show, the admitted maximum value of the debtor's assets is substantially less than the superior claims and interests of the holders of notes and preferred stock before taking into account any claim for Standard. The inescapable result is that Standard's claim, having been subordinated by this Court, has proven to be valueless and hence may not be given recognition in the reorganization.

II.

STATEMENT OF THE FACTS

Since the facts have been fully stated by the Circuit Court of Appeals for the Tenth Circuit (96 Fed. (2d) 693; 113 Fed. (2d) 266) and by this Court (306 U.S. 307), we shall not undertake a restatement and desire only to supply certain important omissions in the petition, as follows:

1. The District Court in the order of February 29, 1940, which gives rise to this proceeding, found that the fair value of the assets and properties of the debtor does not exceed $16,500,000. This finding of value shows no substantial change from the former maximum valuation of $17,000,000 which was approved by this Court. (306 U.S. 307, 314) Standard did not object below to the District Court's finding of value, nor does it challenge that determination by its petition herein.

2. The debt due the holders of the debtor's notes as of March 1, 1940 (after an interim distribution) was $13,000,000 and the interest of the preferred stockholders including dividends accrued to January 1, 1940, was $8,150,000, a total of $21,150,000, being $4,650,000 in excess of the conceded maximum value of the debtor's assets. Without including accrued dividends on the preferred stock, the debt due the holders of notes plus the par value of the preferred stock exceeds the conceded maximum value of the assets by $1,500,000.

3. The claim now advanced by Standard includes no items which were not in Standard's original claim as presented to this Court. (Rec. p. 1271) The record filed with the petition consists for the most part of the evidence in the record on the former appeal. The 1936 compromise of the Standard claim which this Court disapproved was based

on the allowance to Standard of its claims for net cash advances to Deep Rock or on its behalf and a portion of the advances made by Standard in connection with the acquisition and development by Deep Rock of the Bradstreet Acreage and Cracking Plant (the so-called Refining Company assets). (306 U.S. 307, 321) In its petition Standard not only seeks recognition in the reorganization for these cash items constituting the former compromise figure, but also renews its claims based on other items which were excluded in making the compromise. (Pet. p. 9)

4. Throughout the course of the litigation in the trial court, which has been in progress for over seven and one-half years, it has been uniformly claimed that the Refining Company assets belonged to the debtor and that this property, represented by the Refining Company stock, should be restored to Deep Rock free of any indebtedness to Standard. (306 U.S. 307, 320)

5. Prior to October 1, 1925 (the date of the Refining Company lease) Deep Rock was the owner of the stock of the Refining Company and the moneys expended for the acquisition and development of the Bradstreet Acreage and Cracking Plant were owed to Standard or its nominees. As of that date, but somewhat later, Standard undertook to change its position from that of creditor to that of proprietor and directed, through its chief accounting officer, the "sale" of the Refining Company stock to Standard in connection with the contemporaneous lease of the Refining Company assets to Deep Rock. (306 U.S. 307, 317-320) The order of the District Court recognized the invalidity of that transaction and restored the parties to their prior positions, leaving Standard as a creditor for the advances in question, as it was before October 1, 1925. (Rec. Vol. I, pp. 148-152, 159-161)

III.

ARGUMENT.

Summary of Argument.

A. The reasons advanced by petitioner for the allowance of the writ of certiorari are untenable.

B. The order of the District Court is the necessary consequence of the opinion and mandate of this Court in Taylor v. Standard Gas and Electric Company, 306 U. S. 307.

A. The reasons advanced by petitioner for the allowance of the writ of certiorari are untenable.

The petition suggests four reasons for the allowance of the writ (Pet. pp. 24-31), each of which we believe to be without merit for the following reasons:

1. No Injustice Has Been Done.

In support of the assertion that the order of the District Court is unjust Standard urges, first, the merit and equity of certain items in its claim (Pet. p. 25) and then suggests that the public holders of Deep Rock securities, which it characterizes as speculators, should not "profit" at the expense of the public security holders of Standard, who apparently are not considered to be speculators. Of course, both groups consist of members of the public who have from time to time acquired their respective securities by purchase on the open market at prevailing prices.

As to the first ground of alleged injustice:

The items in its claim upon which Standard relies are the same as those formerly presented to and reviewed by this Court. (Rec. p. 1271)

Standard filed its original proof of debt against Deep Rock on June 22, 1934, in the sum of $9,342,642.37 with in-

terest at 6% from February 28, 1933, which amount, as stated in the proof of debt, "is and represents the balance of accounts between Standard Gas and Electric Company and Deep Rock Oil Corporation for a period beginning June 1, 1919, and ending February 28, 1933." After the receipt by the District Court of the mandate of this Court subordinating the entire claim of Standard to the claims of the holders of Deep Rock notes and preferred stock, Standard, on December 28, 1939, filed its amended proof of debt in the sum of $6,129,248.36 covering the period from February 24, 1928* to February 28, 1933. This amended proof of debt did not include any item that had not been included in the original claim (Rec. p. 1271) and differed from the original claim in the following respects only:

(a) The amended claim as a matter of form covered only a portion of the period covered in the original claim, and

(b) There were omitted therefrom the large claims for rent on account of the Bradstreet Properties and Cracking Plant (the Refining Company assets) which had been included in the original claim.

The substance of these eliminated claims was renewed, however, by a petition filed by Standard on January 29, 1940, respecting the Refining Company assets. By this petition Standard sought by a new vehicle to establish its claims in connection with the Refining Company assets originally presented in the form of the claim for rent. (Pet. p. 42) The Refining Company petition states that the lease of the Refining Company assets was entered into "in an attempt to recover" Standard's expenditures in connection with the acquisition and development of such assets. (Rec. Vol. I, p. 119)

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*On this date the Standard claim on open account was balanced by the issuance of Deep Rock stock. (306 U.S. 307, 316)

The 1925 transfer of the Refining Company stock from Deep Rock to Standard, the issuance of the Refining Company note in the principal amount of $1,894,592.11 to Standard, and the contemporaneous lease of the Refining Company assets to Deep Rock were all dictated by Standard and parts of a single transaction. This endeavor by Standard to become the owner of the assets in question has been uniformly condemned by the courts. (96 Fed. (2d) 693, 698, 710; 306 U.S. 307, 318) The parties could only be restored to their positions prior to 1925 by requiring ownership to be returned to Deep Rock and remitting Standard to its position as creditor for the amount of its advances. The mere disaffirmance of the lease, which Standard concedes to be proper (Pet. pp. 42, 65), would be ineffective if Standard's claim to ownership is sustained.

In its former opinion this Court emphasized the Refining Company transactions as illustrating Standard's abuse of its position of domination over Deep Rock. Certainly these very transactions cannot result in giving Standard a valid claim which is immune from the subordination decree, and which Standard can enforce as a condition of the debtor's recovery of the Refining Company assets, which were originally purchased by Deep Rock and acquired for its use and benefit.

All items of the claim of Standard including its claims for reimbursement in connection with the Refining Company assets were before this Court and subordinated by the earlier opinion in this case. Indeed, a substantial portion of the advances made in connection with the Refining Company assets was included in the 1936 compromise allowance which this Court disapproved. (306 U. S. 307, 321) The compromise also provided for the return to Deep Rock of these assets. (306 U. S. 307, 321) We believe that this Court has clearly held, in disapproving the comprom-

ise, that Standard can participate for its various claims including those arising in connection with the Refining Company transactions, only in subordination to the holders of notes and preferred stock.

As to the second ground of alleged injustice:

It is suggested that the allowance to the noteholders and preferred stockholders of priority for the full amount of their claims and interests is an injustice. Standard throughout its petition repeatedly refers to the circumstance that certain of the present holders of notes and preferred stock have acquired such securities at depressed market prices. The only purpose of such statements must be the implicit suggestion that such holders should not be granted satisfaction of their claims in full. (Pet. p. 63) No authority is cited in support of this position.

Standard cannot be heard to contend that its subordinated claim has value on the ground that the claims of other creditors and preferred stockholders should be computed at less than the full face amount. The assignee of a claim is entitled to assert his claim for the full amount irrespective of the consideration which he may have paid for it, in the absence of fraud, actual or constructive.* There is no

**Security-First National Bank of Los Angeles* v. *Rindge Land and Navigation Co.*, 85 Fed. (2d) 557 (C. C. A. 9th, 1936); rehrg. den. 86 Fed. (2d) 3 (1936); cert. den. 299 U. S. 613 (1937); rehrg. den. 300 U. S. 686 (1937).

Texas Hotel Securities Corporation v. *Waco Development Co.*, 87 Fed. (2d) 395 (C. C. A. 5th, 1936); cert. den. 300 U. S. 679 (1937); rehrg. den. 301 U. S. 713 (1937).

In re Utilities Power & Light Corporation, 29 F. Supp. 763, 770 (D. C. Ill. 1939), app. dis. 7 Cir. C. C. A. on March 9, 1940.

In re Radio-Keith-Orpheum Corporation, 106 Fed. (2d) 22, 27 (C. C. A. 2nd, 1939).

Cf. *In re Tennessee Publishing Co.*, 81 Fed. (2d) 463, 466 (C. C. A. 6th, 1936).

Cromwell v. *County of Sac*, 96 U. S. 51, 60 (1877).

Wade v. *Chicago, Springfield & St. Louis Ry. Co.*, 149 U. S. 327, 343 (1893).

authority to the contrary and none is suggested. The consequences of destroying the marketability of securities in a corporation undergoing reorganization would be disastrous.

Not only is Standard's suggestion devoid of support by the authorities, but it cannot stand the test of elementary fairness and equity. The law imposes no fiduciary obligation upon the public holders of Deep Rock securities who purchased at the market price. On the other hand, it was Standard which, through its domination of Deep Rock, directed the issuance of such securities to the public. Standard insists that it does not contest the enforceability of the debtor's obligations in full. (Pet. p. 44) Standard, however, does urge that it should not be subordinated to the full "extent" of the claims of the notes and preferred stock. (Pet. p. 43) Whatever may be the proper technical characterization of the contention, in substance it is an obvious attempt by Standard to repudiate for its own benefit the engagements of Deep Rock represented by its outstanding notes and preferred stock. The promise of Deep Rock to the holders of its notes is to pay principal and interest unpaid to the date of payment. The preferred stockholders' preference rights are correspondingly definite.

We are unable to find in the opinion any qualification by this Court of its determination that the claims and interests of Standard were subordinated to the preferred stock. It follows that the senior interests are entitled to be satisfied in full prior to participation by Standard. Since the assets are even insufficient to meet the debt due the holders of notes plus the par value of the preferred, participation for Standard cannot be permitted.

2. THE ORDER BELOW DOES NOT CONFLICT WITH THE DECISION OF THIS COURT.

In support of the assertion that the order of the District Court did not involve matters already determined by this Court, Standard is required to suggest what this Court did decide. The petition states in this connection (p. 27):

> "What this Court decided in the *Taylor* case had to do with the securities which Standard was to receive under a new plan of reorganization * * *. At no place in its opinion in the *Taylor* case did this Court talk of subordination of Standard or Standard's claim except in terms of an award to Standard of participation in a plan of reorganization * * *."

Such statements contain their own refutation. This Court first stated the requirement of equity that the rights and the status of the preferred stockholders arising out of Standard's misconduct must be recognized. This Court then directed that "equity requires the award to preferred stockholders of a superior position" after satisfaction of the creditors (the noteholders). Subsequently this Court stated in *Pepper* v. *Litton* that the claim of Standard should be allowed to participate only in subordination to the preferred stock. We, therefore, believe it to be clear that Standard's status was fixed as subordinate for all purposes of the proceeding and that this Court did consider and determine "the equities of Standard's position *vis-a-vis* the equities of the positions of preferred stockholders and note holders of Deep Rock." (Pet. p. 21) Certainly Standard's rank or order of participation under a plan can not differ from but merely reflects its status or rank of interest in the assets of the debtor.

The refusal of the District Court, in the light of the value of the debtor's assets and the consequent valueless character of the Standard claim, to determine the validity or

amount of that claim was also consistent with, and not at variance from the prior decision of this Court. Under the opinion of this Court in this case, as repeated in *Pepper* v. *Litton*, the decree of subordination was made on the assumption that the claim or a substantial part of it was "due and owing."

3. THERE HAS BEEN NO DEPARTURE FROM THE USUAL COURSE OF JUDICIAL PROCEEDINGS.

We know of no basis upon which Standard can justify the statement that it was denied due process in the courts below. For seven years Standard has presented by evidence before the Master and in the District Court and by oral and written argument in the District Court, the Circuit Court of Appeals and this Court its contentions respecting its claim and the Refining Company transactions. Since 1933 it has been advised of the Trustee's position that the Refining Company assets should be restored to Deep Rock free of any claim from Standard. This Court itself stated as follows:

> "The Trustee in Bankruptcy attacked this transaction as fraudulent and asserted Deep Rock's ownership of all the property represented by the Refining Company's stock free of any indebtedness to Standard in respect of it." (306 U. S. 307, 320.)

By their former appeal the respondent, Independent Preferred Stockholders' Committee, insisted that the entire Standard claim was invalid, including all of the items relating to the Refining Company transactions. Prior to the hearing on February 27, 1940, Standard had introduced the brief additional evidence it desired to offer respecting the Refining Company transactions. (Rec. Vol. II, p. 1307) Prior to that hearing the respondents by their answers to the Refining Company petition (filed January 29, 1940) had

reiterated their consistent position that the Refining Company assets should be restored to the ownership of Deep Rock. (Rec. Vol. I, pp. 137, 142, 144, 147)

For Standard now to suggest that there was no issue raised with respect to the restoration to Deep Rock of the Refining Company stock and the cancellation of the Refining Company note held by Standard can only be explained as an inadvertent and careless disregard of the record. The order of the District Court simply put into effect by proper mechanics the fundamental conclusion that Deep Rock was in equity the owner of the Refining Company assets.

It is suggested in the petition that Standard was denied a hearing on the merits by the Circuit Court of Appeals. (Pet. p. 3) This statement is entirely without foundation. The substance of the motions to dismiss and affirm upon which the Circuit Court of Appeals acted presented all of the meritorious issues in the case. (Rec. pp. 1362-1366; 1371) This was recognized by Standard, which urged by brief and oral argument in the Circuit Court of Appeals substantially the same contentions which it here presents. (Rec. pp. 1372-1378)

4. THERE IS NO IMPORTANT PUBLIC ISSUE INVOLVED.

This proceeding, which has been so long before the courts and which has already been determined in all essential respects by this Court, certainly does not now involve any questions of law of importance to the public as distinguished from the private litigants. *Layne & Bowler Corporation* v. *Western Well Works,* 261 U. S. 387, 393 (1923) We submit that Standard is merely seeking to retry the issues which have already been adjudicated adversely to it by this Court. Standard's continued effort by the instant petition will further delay the consummation of the reorganization of the debtor to the detriment of the public

security holders. If there ever was a case where the discretion of this Court should be exercised in assisting the lower courts and the parties to break the jam and at last achieve constructive results, it is here presented.

We fail to understand how the fact that Standard itself has been reorganized in bankruptcy and now has a new management can affect or change the consequences which this Court has decreed must follow the mismanagement which occurred during the period while the claim arose. (Pet. p. 31)

B. The order of the District Court is the necessary consequence of the opinion and mandate of this Court in Taylor v. Standard Gas and Electric Company, 306 U. S. 307.

We have shown above that the order of the District Court does not conflict with the former opinion of this Court. In addition, we submit that the order below was the necessary consequence of that opinion. When this Court subordinated Standard to the preferred stockholders it necessarily held that all of the legal consequences of such subordination would follow. Since the conceded value of the assets of the debtor is insufficient to satisfy the claims of the holders of notes and the interests of the preferred stockholders, nothing remains for Standard in its subordinated position.* If Standard were permitted to participate in a reorganization plan under such conditions, the decree of subordination would be nullified. If Standard were to receive securities for its worthless interest, value would thereby be taken and diverted from the senior classes. This

*Since Standard does not challenge the District Court's finding of value, there is no necessity to comment upon the discussion (Pet. pp. 49-51) respecting the fluctuating earnings of Deep Rock. Of course, earnings, past, present and prospective, are all elements given consideration in determining value.

would not be subordination. Subordination means participation after, and only after, prior claims have been satisfied in full.

Since the balance of value remaining "after satisfaction of the creditors" is not equal even to the par value of the preferred stock, it is obvious that a division (as suggested in the petition, page 43) of that balance between the preferred stockholders and Standard could not accord with equitable principles. Such a division would deprive the preferred stockholders of the "superior position" awarded them.

Case, et al., v. *Los Angeles Lumber Products Company,* 60 S. Ct. 1, 308 U. S. 106 (1939).

Railroad Company v. *Howard,* 7 Wallace 392 (1868).

Louisville Trust Company v. *Louisville, New Albany and Chicago Ry. Co.,* 174 U. S. 674 (1899).

Northern Pacific Ry. Co. v. *Boyd,* 228 U. S. 482 (1913).

Kansas City Terminal Ry. Co. v. *Central Union Trust Company of New York,* 271 U. S. 445 (1926).

Securities and Exchange Commission v. *U. S. Realty and Improvement Co.,* 60 S. Ct. 1044 (1940).

It need hardly be suggested that the applicability of the established principle of the *Boyd* case to bankruptcy reorganization proceedings should not be relaxed in favor of Standard, which occupies its subordinated position as the result of its own conduct, which this Court has found to be "wrongful and injurious." Since, as a matter of equity, the public holders of all junior securities representing no remaining equity or asset value cannot participate in any reorganization, then surely Standard, in the light of the record in this case and the facts as determined by this

Court, cannot be accorded different or better treatment. *In re 620 Church Street Building Corporation,* 299 U. S. 24 (1936).

Standard's loss was caused by the substantial reverses suffered by the debtor prior to the institution of this proceeding, which depleted its assets to a point where the equity of interests subordinate to preferred stockholders had ceased to exist. The decree here complained of leaves Standard neither richer nor poorer than it was theretofore. An equity cannot be created for Standard where none exists.

By a novel and unsound process of reasoning Standard undertakes to compute an equity for its subordinated position by urging the disallowance of interest on the unpaid debt due the holders of Deep Rock notes. (Pet. pp. 59-63) It would indeed be a curious result of this Court's finding that Standard mismanaged Deep Rock (and of the decree of subordination which followed) that the claim of the noteholders must be limited to the principal of their debt. Since Standard is subordinated to the preferred stock, it is, of course, subordinated to the notes, principal and interest.

Furthermore, the law is clear that interest must be paid in full on claims in the order of their priority. This principle is firmly established in the law of both equity and bankruptcy reorganizations. The rule that where a debtor is insolvent no interest on claims accrues during the pendency of receivership or bankruptcy proceedings clearly cannot apply where the claims are of different rank of priority.

American Iron Co. v. *Seaboard Air Line Ry.,* 233 U. S. 261, 266 (1914).

Board of Commissioners of Sweetwater County v. *Bernardin,* 74 Fed. (2d) 809, 815 (C. C. A. 10th, 1934), Cert. Den. 295 U. S. 731 (1935).

In re Barclay Park Corp., 90 Fed. (2d) 595, 597 (C. C. A. 2nd, 1937).

Spring Coal Co. v. *Keech*, 239 Fed. 48, 51 (C. C. A. 4th, 1916).

In re Wickwire Spencer Steel Co., 12 F. Supp. 528, 535 (D. C. N. Y., 1935).

Fletcher, Private Corporations, Vol. 16, Chap. 64, Sec. 7937, page 632.

The controlling and obvious principle is that since the preferred stockholders of the debtor are to participate in the reorganization the note holders must be satisfied in full, both principal and interest. *Case, et al.* v. *Los Angeles Lumber Products Company*, 60 S. Ct. 1, 308 U. S. 106 (1939).

CONCLUSION.

Standard has already been fully heard in the District Court, twice in the United States Circuit Court of Appeals and once in this Court. This Court has decreed that Standard must be subordinated to the holders of preferred stock. The District Court has found that interests subordinate to preferred stock have no value and Standard has acquiesced in that finding. When a case has been determined by this Court a litigant must of necessity be foreclosed from relitigating his cause.

We respectfully urge that the petition for certiorari should be denied.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 465

STANDARD GAS AND ELECTRIC CO., PETITIONER

v.

JOHN M. TAYLOR ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

The Securities and Exchange Commission, named in the petition as intervener, is participating in the reorganization proceeding with the approval of the District Judge, pursuant to the provisions of Sections 208 and 276 c(2) of Chapter X of the Bankruptcy Act, as amended, c. 575, 52 Stat. 894, 905 (11 U. S. C., Secs. 608, 676 c(2)).

OPINION BELOW

The opinion of the Circuit Court of Appeals for the Tenth Circuit (R. 1372–1378) is reported in

113 F. (2d) 266. The decree of the District Court (R. 159–161) and the findings of fact and conclusions of law on which it is based (R. 148–152) are not reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 29, 1940 (R. 1378). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the decree of the District Court requiring the subordination of petitioner's claims to the claims and interests of the noteholders and preferred stockholders of the debtor, with the consequent exclusion of petitioner from participation in the reorganization, complies with the mandate of this Court in *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307.

2. Whether the District Court in determining the status of petitioner's claims denied it procedural due process or deprived it of its property without due compensation.

STATEMENT

The present controversy arises in the same reorganization proceeding which was before this Court in *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307 (hereinafter referred to as the "Taylor" case). In that case this Court reversed a

decision of the United States Circuit Court of Appeals for the Tenth Circuit which had affirmed orders of the United States District Court for the Northern District of Oklahoma confirming a plan of reorganization for Deep Rock Oil Corporation. The plan had been predicated on a compromise of certain claims asserted as a creditor by Standard Gas & Electric Co. (hereinafter called "Standard"), the owner of substantially all of the common stock of the debtor. This Court disapproved the plan because of the participation accorded Standard, deciding that the abuses in the management of the debtor by Standard required that Standard's claim as a creditor be subordinated to the interests of the debtor's preferred stockholders. The facts upon which that decision was based were stated in detail in this Court's opinion and are therefore not repeated here.

The claims of the noteholders and preferred stockholders, to which Standard's claim was required to be subordinated, exceeded in amount the value of the debtor's assets.[1] Accordingly, the "Reorganization Committee" subsequently filed a new or amended plan of reorganization in which Standard's claim, for which no value remained, received no participation (R. 42–72). Shortly thereafter Standard filed an "amended" claim (R. 91) which involved no items not included in the claim before this Court in the *Taylor* case (R. 1271). It

[1] The valuation of the debtor's assets is unchallenged by Standard.

differed from the original claim in that it covered only the period from 1928, when the account between the debtor and Standard was balanced, to 1933, the inception of the reorganization proceedings, and excluded any reference to the so-called Bradstreet Properties and Cracking Plant.[2] Standard's claims with respect to these properties were asserted, however, in a petition (R. 117) filed by it on January 29, 1940, alleging ownership of the properties, through the Refining Company, and seeking both compensation for the use of such assets and the return of the assets or reimbursement of Standard's "investment" therein, with interest. Hearings were held on the claim and petition and evidence was introduced by Standard in support of its claim (R. 1184–1319; Pet. 16).

The District Court found as facts (R. 149–150) (1) that as of March 1, 1940, the debtor's obligations to its noteholders totalled $10,000,000 for principal and $3,000,000 for interest; (2) that the liquidation preference of the 50,000 shares of the debtor's preferred stock was $5,000,000 plus cumulative dividends totalling $3,150,000; and (3) that the value of the debtor's assets did not exceed $16,500,000.[3] The court found, further, that the Refin-

[2] The history of these properties (hereinafter called the "Refining Company's properties") and of Deep Rock Oil and Refining Company (hereinafter called the "Refining Company") is referred to in the *Taylor* case. 306 U. S. at 317–320.

[3] This amount corresponds to the maximum valuation of $17,000,000 accepted by this Court in the *Taylor* case, after giving effect to interim changes. 306 U. S. at 314.

ing Company's properties had been acquired by and for the debtor and belonged to it and that any claim Standard might have arising out of transactions concerning such properties and the Refining Company was that of a creditor having a claim for money against the debtor. Such claim was declared to be of identical character with all other claims of Standard against the debtor.

The District Court's conclusions of law were that (1) Standard's claims of whatever nature, including its claims with respect to the Refining Company's properties, were subordinate to the claims of the noteholders and the interests of the preferred stockholders; (2) that the amount of such prior claims exceeded the entire asset value of the debtor; and (3) hence, that Standard's claims were of no value and were not entitled to any participation in the reorganization (R. 150–251). The District Court also determined, as a matter of law, that the debtor was the owner of the stock and properties of the Refining Company (R. 151). Inasmuch as the court had found that Standard's claims in respect of the Refining Company's properties were claims only against the debtor, it followed that they were invalid as claims against the Refining Company. The court concluded, therefore, that the note of the Refining Company held by Standard[4] should be discharged

[4] This note had been issued by the Refining Company to evidence the assumption by it of the debtor's obligation to Standard for advances in connection with the original acqui-

and that Standard should deliver to the debtor the stock and note of the Refining Company and documents evidencing title to its assets (R. 151–152).[5] Since Standard's claims, including those with respect to the Refining Company's assets, were found to be entitled to no participation in the reorganization, the District Court made no finding as to the amount or validity of the claims.

A decree was entered in conformity with these findings of fact and conclusions of law (R. 159). From this decree Standard appealed to the Circuit Court of Appeals, which affirmed[6] the decree. This petition for writ of certiorari is sought to review the decision of the Circuit Court of Appeals.

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sition of the properties. This assumption was related to the transactions discussed in the *Taylor* case, whereby Standard purported to take over the stock of the Refining Company from the debtor in 1925. 306 U. S. at 317–320.

[5] In effect, the court declared invalid the original transactions by which Standard purported, as of October 1, 1925, to take over from the debtor the stock and assets of the Refining Company, and restored legal title to such stock and assets to the debtor, remitting Standard to its claim against the debtor in the amount which was cancelled by the bookkeeping entry of October 1, 1925, and any proper additions.

[6] The respondents, including this Commission, moved to dismiss the appeal below on the ground that, inasmuch as Standard's principal objection to the decree of the District Court was to that court's construction of this Court's mandate (see R. 164), and since only this Court had jurisdiction to construe the mandate, the Circuit Court of Appeals could not entertain the appeal. See *Ex parte First National Bank*, 207 U. S. 61; and *Texas and Pacific Railway Co.* v. *Anderson*, 149 U. S. 237. The Circuit Court of Appeals denied the

ARGUMENT

It is the position of the Securities and Exchange Commission that the District Court correctly construed the mandate of this Court, and that its decree excluding Standard from participation in the reorganization followed inevitably both from the requirement of subordination directed by this Court and from the application to the case of well-settled principles of law. With respect to this decree, Standard has been afforded every requirement of due process of law.

I

In the *Taylor* case this Court disapproved a plan of reorganization, in which Standard's claims as a creditor were compromised in the amount of $5,000,000, because of the participation accorded Standard's claim. In considering the plan which was based on the compromise this Court examined all of the claims of Standard and concluded, in view of Standard's abuses in the control and man-

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motion to dismiss but affirmed the District Court's decree on the motion of one of the respondents to dismiss or to affirm, in the alternative. While we call the Court's attention to this question of the jurisdiction of the Circuit Court of Appeals, we do not now urge this point. Whether or not the ruling of the Circuit Court of Appeals was correct, any error in denying the motion to dismiss was harmless, since we believe that the affirmance was based on a correct construction of this Court's mandate. If this Court should now reverse the Circuit Court of Appeals with directions to dismiss the appeal, the result would be only to delay the termination of these long-pending proceedings.

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agement of the debtor, that "Equity requires the award to preferred stockholders of a superior position in the reorganized company", and that "No plan ought to be approved which does not accord the preferred stockholders a right of participation in the equity in the Company's assets prior to that of Standard, and at least equal voice with Standard in the management" (306 U. S. at 323, 324). In *Pepper* v. *Litton,* 308 U. S. 295, this Court said (p. 308):

> In *Taylor* v. *Standard Gas & Electric Co.,* 306 U. S. 307, this Court held that the claim of Standard against its subsidiary (admittedly a claim due and owing) should be allowed to participate in the reorganization plan of the subsidiary only in subordination to the preferred stock of the subsidiary. This was based on the equities of the case—the history of spoliation, mismanagement, and faithless stewardship of the affairs of the subsidiary by Standard to the detriment of the public investors.

We believe it clear that the Court contemplated that Standard's claim was to be subordinated to the interests of the preferred stockholders and that the District Court correctly so held.

In view of the subordination required by this Court, and the finding of the District Court that the value of the debtor's assets is less than the amounts of the prior claims of the noteholders and preferred stockholders, the District Court necessarily concluded that Standard's claims were en-

titled to no participation in the reorganization. Any other conclusion would have failed to give full effect to the requirement of subordination of Standard's claims directed in the *Taylor* case, and would have been contrary to the controlling decisions of this Court in *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, and *In re 620 Church Street Bldg. Corp.*, 299 U. S. 24.

The arguments advanced in Standard's petition in opposition to these conclusions are insubstantial and do not warrant review by this Court.

1. Standard contends that its claims are valid and meritorious and entitled to participation for the greater part, if not entirely, on a parity with the claims of the noteholders. These claims, it is stated (Pet. Brief 35–36, 52–58), include net cash advances, part of which were used by the debtor and part paid to the security holders of the debtor as interest and dividends; interest on Standard's loans to the debtor; interest on securities of the debtor held by Standard; Standard's "investment" in the Refining Company's assets and compensation for the use thereof by the debtor; and claims for services rendered by the affiliated management corporation. Standard's claims for cash advanced to the public security holders and for its "investment" in the Refining Company's assets are stated to be especially entitled to participation (Pet. 25, Brief 35, 51, 53). It urges further that its claims for dividends declared but unpaid on the

preferred and common stocks held by Standard are entitled at least to a position of seniority to the preferred stockholders' claims.

These items were all in the account considered and required to be subordinated in the *Taylor* case (R. 1271). In its opinion (pp. 311–312), this Court stated that the claim before it included "Cash payments by Standard to Deep Rock, or to others for its account, as shown by the books"; "Management and supervision fees paid or credited to Management Corporation"; "Interest charges by Standard to Deep Rock on open account balances"; "Rental charges upon a lease to Deep Rock of oil properties owned by a Standard subsidiary but claimed by petitioners to belong, in equity, to Deep Rock"; "Debits by Standard to Deep Rock of the amounts of dividends declared by Deep Rock to Standard, but not paid"; and "hundreds of debits and credits representing other intercompany items." The claim with respect to the Refining Company's assets was discussed by the Court at length (pp. 317–320). The fact that the claim included advances for payment of dividends to outsiders was mentioned (pp. 316–317). In its opinion this Court also pointed out (pp. 321–322) Standard's contention that, eliminating from the account dividends, management fees and all other questionable items, net cash advances since 1928 (when the present "amended claim" begins) plus the claims relative to the Refining Company's properties equalled the compromise figure, and that

at least as to such amount, there could be no criticism of the recognition of Standard's claim (pp. 321–322). Notwithstanding this contention by Standard, the entire claim was required to be subordinated.

No new matter has now been introduced. Standard's claim is the same as before. As to the validity of the claim, Standard's contentions are unimportant. In view of the debtor's valuation and the amount of senior claims, Standard's subordinated claim is necessarily without value in fact, whatever the amount at which it might be established.

2. Standard also contends that it is inequitable to subordinate its claims to the interests of the preferred stockholders. It asserts first that it has not violated its fiduciary duty; that there is no evidence in the record of mismanagement by Standard, or of damage to debtor's security holders as a result of any act or omission of Standard, or of any benefit to Standard from its relationship with the debtor. This is manifestly an attempt to relitigate the *Taylor* case, where this Court determined each of these issues.

Standard urges further not only that its claim is meritorious but that it would be particularly inequitable to subordinate it because of the nature of the claims of some of the debtor's public security holders. Standard contends that many noteholders and preferred stockholders of the debtor acquired their securities on the market at substan-

tial discounts and that they would receive a windfall [7] if they were permitted to participate in the reorganization for the full amount of their claims. Since any participation by Standard would be at the expense of the public claimants, the "windfall" argument is an attempt to reduce the senior claims in order to impart value to Standard's subordinated claim. This argument of Standard is without merit or authority. The assignee of a claim is entitled to assert it for the full amount, regardless of the price paid,[8] unless there is fraud. Standard has neither alleged nor established fraud. The adoption of the principle urged by Standard would destroy the marketability of the securities

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[7] Standard assumes that large profits will accrue to the security holders under the plan confirmed by the District Court. See, however, the advisory report of the Securities and Exchange Commission on the value and prospects of the debtor. S. E. C. Corporate Reorganization Release No. 23, April 26, 1940.

[8] *Security-First National Bank of Los Angeles* v. *Rindge Land & Navigation Co.*, 85 F. (2d) 557 (C. C. A. 9th, 1936), rehrg. denied, 86 F. (2d) 3, certiorari denied, 299 U. S. 613, rehrg. denied, 300 U. S. 686; *Texas Hotel Securities Corporation* v. *Waco Development Co.*, 87 F. (2d) 395 (C. C. A. 5th), certiorari denied, 300 U. S. 679, rehrg. denied, 301 U. S. 713; *In re Utilities Power & Light Corporation*, 29 F. Supp. 763, 770 (N. D. Ill.), app. dism., C. C. A. 7th, on March 9, 1940; *In re Radio-Keith-Orpheum Corporation*, 106 F. (2d) 22, 27 (C. C. A. 2d). Cf. *In re Tennesseee Publishing Co.*, 81 F. (2d) 463, 466 (C. C. A. 6th), aff'd, 299 U. S. 18; *Cromwell* v. *County of Sac*, 96 U. S. 51, 60; and *Wade* v. *Chicago, Springfield & St. Louis R. R. Co.*, 149 U. S. 327, 343.

of corporations in reorganization. Furthermore, Standard has no equities against the bona fide purchasers of the debtor's securities to justify a disregard of their contractual rights.

Standard urges, further, that its claims should not be excluded from the reorganization because the debtor's properties and business are speculative in nature. The speculative nature of the enterprise, however, was necessarily an element involved in the valuation to which Standard has not objected. Its present contention is merely an attempt to justify its participation in the reorganization despite the absence of value for its claims.

3. Standard denies that the lower courts' interpretation of the opinion of this Court was correct (Pet. 25 and 27). In order to reassert its claims on a parity with those of the noteholders, it contends that "the *Taylor* case dealt with a voluntary, agreed-upon reorganization, whereas the order now appealed from is one of complete bar and foreclosure against Standard" (Pet. 25); that this Court in the *Taylor* case did not "talk of subordination" of Standard's claims except in terms of award to Standard of participation in a plan of reorganization (Pet. 27–28) and that the securities thus to be received by Standard were to represent voting rights not greater than those allotted to the preferred stockholders; that "it is clear too that this Court's opinion assumed that the parties

would ultimately agree on a new plan of reorganization, consistent with the opinion" but that such agreed-upon plan was found to be impossible (Pet. 27); and that "In the *Taylor* case, this Court did not, and on the record before it could not, decide the exact extent of the priorities of note holders and preferred stockholders over the claim of Standard as a creditor" (Brief 43). Standard then urges that it is entitled to a participation in a plan on a parity with the noteholders for the greater part, if not all, of the claim which it now advances (Pet. 25, 35–36; Brief 52–58).

If we correctly understand these contentions, they would interpret the opinion in a manner which would render the decision of this Court meaningless. Apparently Standard argues that this Court did not determine the status of Standard's claims except in relation to the participation which Standard could receive in a "voluntary, agreed-upon reorganization", and that, absent such an agreement, Standard is not to be subordinated to the preferred stockholders, but on the contrary is entitled to have its claims participate on a parity with the claims of the noteholders. Under that interpretation, Standard's claims would be subordinated to those of the preferred stockholders only upon, and to the extent of, its agreement, and Standard would control the adoption of a plan. Such an interpretation is obviously untenable.

4. Standard then argues that, assuming subordination, its claims are entitled to participate because the claims of the senior security holders do not exhaust the assets of the debtor. Its contention is that for the purpose of measuring the participation of the noteholders' and stockholders' claims in the plan of reorganization, interest on the notes and dividends on the preferred stock accrued after the commencement of the proceedings must be disregarded. It is unnecessary, however, to consider the matter of preferred stock dividends. After providing for the payment of the noteholders' claims for principal and interest, the value of the debtor's assets is insufficient to satisfy in full the claims of the preferred stockholders, exclusive of accrued dividends.

Standard's contention with respect to interest on the debtor's notes is based on the assumption that, adding its claim to that of the noteholders, the debtor is insolvent. The case is thus argued to come within the rule that interest will not be accrued in favor of the unsecured creditors of an insolvent corporation. But this argument ignores the subordination of Standard's claim to that of the preferred stockholders, and necessarily to that of the noteholders. Where, as in this case, the assets are sufficient to satisfy the claims of the noteholders in full, including interest, it is clear that, even in bankruptcy, such interests must be satisfied before junior security holders are permitted to participate. This Court in *American Iron and Steel*

Co. v. *Seaboard Air Line Ry.*, 233 U. S. 261, 266–267, said: [9]

> * * * in case funds are not sufficient to pay claims of equal dignity, the distribution is made only on the basis of the principal of the debt. But that rule did not prevent the running of interest during the Receivership; and if as a result of good fortune or good management, the estate proved sufficient to discharge the claims in full, interest as well as principal should be paid. Even in bankruptcy * * * it has been held, in the rare instances where the assets ultimately proved sufficient for the purpose, that creditors were entitled to interest accruing after adjudication. * * *
>
> The principle is not limited to cases of technical bankruptcy, where the assets ultimately prove sufficient to pay all debts in full but principal as well as interest, accruing during a receivership, is paid on debts of the highest dignity, even though what remains is not sufficient to pay claims of a lower rank in full. * * *

On the facts of this case, it is clear that the rule relied upon by Standard is inapplicable.

II

Standard contends (Pet. 30) that that portion of the decree of the District Court relating to the Re-

[9] See, also, *Board of Commissioners of Sweetwater County* v. *Bernardin*, 74 F. (2d) 809, 815 (C. C. A. 10th), certiorari denied, 295 U. S. 731; *In re Barclay Park Corporation*, 90 F. (2d) 595 (C. C. A. 2d).

fining Company's properties is unfair and involves a violation of substantive and procedural due process.

1. The transaction by which Standard purported to acquire the stock of the Refining Company was considered and condemned by this Court in the *Taylor* case.[10] Subsequently, when the issue of ownership of the property was raised in this proceeding, the District Court, in compliance with the obvious intention of this Court in the *Taylor* case, decreed the reversal of the transfer of October 1, 1925, and restored the parties to the positions they occupied before that transaction. The debtor was found to be the owner of the properties [11] and Standard was remitted to its remedies as a creditor on its original claim for advances.

Standard contends that the decree ordering the transfer of the note and stock and properties of the Refining Company to the debtor deprived Standard of its property without due compensa-

[10] 306 U. S. at pp. 317–318.

[11] In order to effectuate the decree, the District Court ordered Standard to surrender to the debtor certain title documents and the note and stock of the Refining Company. The note of the Refining Company was issued at the time of the original transfer, to evidence the assumption by the Refining Company of the debtor's obligation to Standard for advances as part of the purported consideration for the transfer. Inasmuch as the District Court, in effect, invalidated the transfer and restored Standard to its original position as a creditor of the debtor in respect of such advances, the note of the Refining Company evidencing the same advances was required to be cancelled.

tion. Its premise, however, is unsound. The property did not belong to Standard but to the debtor, and Standard has lost nothing except the fruits of an illegal transaction. It has not been deprived of its claim for the original advances, the only property to which it was entitled. Those advances, moreover, are merely part of its general claims, and their exclusion from participation in the reorganization, because the debtor's assets are insufficient in value to satisfy senior claims, is no deprivation of substantive due process of law. *In re 620 Church Street Bldg. Corp.*, 299 U. S. 24.

Standard's argument that, as a matter of equity, it is entitled to some compensation for the property is not supported by the cases upon which it relies. In those cases [12] the constructive trustee or wrongdoer improved or expended funds on the property while such property was in its possession, and compensation was allowed for the expenditures or improvements. In Standard's case, however, the original advances were made before the attempted transfer and gave rise only to a claim on open account. That claim, for whatever it was worth, was restored by the decree of the District Court. Standard added nothing to the Refining Company's properties after the illegal transaction,

[12] *Southern Pacific Company* v. *Bogert*, 250 U. S. 483; *Thomas* v. *Brownville, etc., R. Co.*, 109 U. S. 522; *McCandless* v. *Furlaud*, 296 U. S. 140, 167.

and the reversal of the transaction deprived it of nothing which it owned.

2. Standard contends, further (Pet. 30), that—

> In no pleading before the Court was an issue raised with respect to whether the note of the Refining Company held by Standard was valid or whether Standard should be directed to mark such note "paid", or whether Standard had received payment of such note; in no pleading before the Court was an issue raised as to whether Standard should be affirmatively ordered to transfer the stock of the Refining Company to the Debtor without receiving compensation. Standard was therefore denied notice and hearing, essential prerequisites of due process.

These contentions are wholly without merit. On January 29, 1940, Standard filed a petition asserting that the Refining Company was the owner of the Bradstreet Properties and Cracking Plant and that the stock of the Refining Company was owned by Standard. The petition requested the District Court to direct that the trustee in bankruptcy pay compensation to it for his use and occupancy of such properties, and that he surrender possession and control of such property or pay to Standard the amount of its "cash investment" in the Refining Company, with interest (R. 117–123). The respondents filed answers denying Standard's title to the properties and praying the court to de-

cree that the properties were beneficially owned by the debtor and to direct Standard to cause legal title to the properties to be conveyed to the trustee, or in the alternative to deliver to the trustee the capital stock of the Refining Company and its unpaid note held by Standard (R. 137–148).

These pleadings put in issue the title to the properties. The District Court had jurisdiction to decide that matter in a summary proceeding. The Refining Company's assets were in the possession and control of its trustee in bankruptcy;[13] and Standard itself had invoked that summary jurisdiction.[14] As an incident to that question of title, the pleadings put in issue the disposition of the stock and note of the Refining Company. The cancellation of the note and the return of the stock and note to the debtor were necessary incidents of the reversal of the original transaction of 1925 in which the note had been issued and the stock transferred to Standard.

On the issues thus raised Standard had its day in court. At the hearing on January 29, counsel for Standard introduced certain exhibits pertinent to its petition, including the record on Standard's claim before this Court in the *Taylor* case (R. 1262–1264, 1274; see Pet. 16). On January 30 he

[13] See *Thompson* v. *Magnolia Petroleum Co.*, 309 U. S. 478.

[14] See *James Talcott, Inc.* v. *Glavin*, 104 F. (2d) 851, 853 (C. C. A. 3d), certiorari denied, 308 U. S. 598.

introduced additional exhibits (R. 1275–1276), and apparently closed his case (R. 1307). Subsequently, respondents filed their answers to Standard's petition. The hearing was resumed on February 27 but Standard's counsel made no further attempt to introduce testimony (R. 1313–1319). The District Court had before it a full record on which Standard had ample opportunity to be heard.

CONCLUSION

Most of petitioner's contentions have already been decided by this Court. The decisions of the courts below were inevitable under the *Taylor* decision and raise no issues of importance. There is no conflict of decision. It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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